Exhibit F
Part 3 of 4

Stock Option Accounting

In November 2006, we announced we had commenced a voluntary review of historical stock option practices under the leadership of the Governance Committee following a preliminary review by management which identified potential deficiencies and discrepancies in the documentation of stock option grants. The review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 ("Review Period") for compliance with the various stock–based compensation accounting standards applicable during the Review Period as well as the rules of our stock option plans. The Governance Committee engaged independent outside legal counsel to assist in the review who, in turn, engaged forensic accountants. (Separate law firms and separate forensic accounting firms were engaged by the Audit Committee and the Governance Committee for the China sales investigation and the stock option accounting review.) In the rest of this discussion, this group collectively is referred to as the Stock Option Review Team and their actions and activities are referred to as the Stock Option Review. The Stock Option Review Team members spent over 11,000 hours in this review, and the Governance Committee met with the Stock Option Review Team on more than a dozen occasions to receive, discuss, and consider the Stock Option Review Team's information and findings.

At the time the review commenced, the Governance Committee consisted of three members of the Board of Directors, all of whom are independent directors. The Committee decided to delegate supervision of the review to Mr. Jeff Clarke, its Chairman, who joined our Board in 2005 and had not served on the Compensation Committee of the Board of Directors ("Compensation Committee") during the period under review. The Governance Committee also consisted of two other independent directors, Mr. Larry D. Horner and Mr. Thomas Toy, who also serve on the Board's Compensation Committee. Mr. Allen Lenzmeier was appointed to the Governance Committee on April 27, 2007.

Review procedures included:

- interviews of individuals involved with granting, advising, administering, or accounting for stock options, including current and former: management, members of the Board of Directors, employees, and non–employee professionals;
- review of relevant stock administration, human resource, legal, and finance department files and records;
- review of stock option grant information in select employee personnel files;
- review by at least 30 attorneys and 15 forensic accountants of approximately 250,000 potentially relevant e–mails and documents in electronic format selected through electronic discovery techniques from over 1.8 million electronic documents processed;
- review of the electronic database of the Company's stock option activity maintained by a third party along with communications to and from this service provider;
- reconciliation of grant activity from approval documents executed by the Compensation Committee with the electronic database;
- reconciliation of stock option grant, exercise, and cancellation information from SEC filings with select employee personnel files and the electronic database;
- statistical and judgmental pattern analysis;
- follow–up on matters raising questions about the option granting process and its history, conduct of those involved with granting, advising, administering, or accounting for stock options, or the accounting treatment for stock options; and
- follow–up on items or issues requested or identified by management or the Company's independent registered public accounting firm.

The Stock Option Review Team, management, and the Governance Committee decided to group stock option grants into six award categories based on differences in what constituted substantive approval for each category under our stock option granting practices as well as giving consideration to the risk of intentional misstatement of the grant date. Guidance in a September 19, 2006 letter publicly issued by the SEC's Chief Accountant focuses on the concept that a measurement date under Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* ("APB 25"), the accounting standard governing our stock option accounting through 2005, does not occur until the number of shares an individual employee is entitled to receive and the exercise price is determined with finality (i.e., no longer subject to change). This is the

date on which substantive approval occurred, and depending on a company's facts and circumstances the guidance from the SEC discussed above recognizes a company may determine that the measurement date for some stock option grants may occur before all required granting actions have occurred – such as final approval by the Compensation Committee. This alternative is available only when a review of all facts and circumstances supports a conclusion that substantive approval occurs earlier than when all required granting actions have occurred and there is no evidence of fraudulent or manipulative conduct in the company's option granting practices.

In determining the measurement date to be used, the Stock Option Review Team, management, and the Governance Committee agreed to use the following definitions as constituting the proper measurement date, and generally these dates were used in testing the stated grant dates or establishing corrected measurement dates:

Discretionary Director and Officer Grants	The date of a Compensation Committee meeting where the grant was approved or the date the final Compensation Committee signer approved the grant when approval occurred through unanimous written consent documents ("UWC").
Automatic Director Grants	The date specified in the relevant stock option plan.
Broadbase	The date the grantee list, including the allocation of shares to individual grantees, was complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Acquisition	The first Compensation Committee meeting following the acquisition, provided grantees had received employment offer letters stating the number of stock options to be granted before such date, because this was the date at which the option exercise price was established. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
New Hire	The first scheduled Compensation Committee meeting following the first day of employment, because this was the date at which the option exercise price was established. The number of options was based on either grant amounts specified in an employment offer letter or, in some cases, on a matrix that assigned grant amounts based on position and level within the Company. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Other Merit	The date the grantee list, including the allocation of shares to grantees, was substantially complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.

For 12 tested grant dates where a corrected measurement date was required, the Stock Option Review Team and management were unable to locate sufficient evidence to establish a corrected measurement date using our established criteria for the applicable option grant type. In these situations alternative available evidence was used to establish the corrected measurement date.

During the period covered by the Stock Option Review, we granted stock options on approximately 34 million shares of our Common Stock at 197 grant dates. The review specifically examined the appropriateness of the stated grant date for approximately 90% of the stock options granted, including all stock option grants made to directors and officers, all broadbase grants and all option grants made in connection with business acquisitions.

The findings of this review are summarized as follows:

Grant Type	Number of grants	Grants tested	No change required	Measurement date changed: additional compensation expense required	Measurement date changed: no additional compensation expense required(1)
Discretionary Director & Officer	16	16	8	4	4
Automatic Director	5	5	5	—	—
Broadbase	8	8	—	6	2
Acquisition	10	10	10	—	—
New Hire	166	48	48	—	—
Other Merit	96	41	4	21	16
Total	301(2)	128	75	31	22

(1) Under APB 25 there is no expense adjustment arising from using the corrected measurement date for these grants because the amount the employee would have to pay to exercise these stock option grants exceeded the quoted market price of our Common Stock at the corrected measurement date, and therefore, these stock option grants contained no intrinsic value at the corrected measurement date.

(2) The number of grants exceeds the number of grant dates because on certain grant dates more than one category of stock option grants were approved.

In late January 2007 the Governance Committee reported its interim findings concerning the use of incorrect measurement dates in our stock option accounting under APB 25 to our Board of Directors. On February 1, 2007, the Audit Committee of the Board of Directors then concluded, in consultation with and upon the recommendation of management, that we should correct for errors in previously reported stock–based compensation expense through restatement of our previously issued financial statements and that our previously issued financial statements for all periods should no longer be relied upon. We communicated this decision in a February 1, 2007 public announcement.

A non–cash compensation charge, to be recognized as an expense over a grantee's service period, arises under APB 25 if a stock option has intrinsic value at its measurement date. This intrinsic value is measured by the excess, if any, of the fair value at the date of grant of the underlying common stock over the stock option's exercise price. Our practice has been to grant stock options with exercise prices equal to the closing price of our Common Stock at each grant date, to use the grant date as the measurement date for stock–based compensation purposes, and as such previously we had determined the granted stock options had no intrinsic value at their grant dates and no compensation expense was recognized. However, APB 25 states the measurement date does not occur until all essential actions necessary to grant the option are completed, including the final determination of both the number of shares to be granted to each employee or director and the exercise price, and the option grant is approved by those with requisite authority. This is reinforced by the September 19, 2006 letter issued by the SEC's Chief Accountant which focuses on the need for the number of shares and exercise price of an award to an individual to be finalized to have a measurement date. This letter clarifies the SEC staff's view that if it is possible that those terms could change, a measurement date has not occurred, even if the award's terms are not actually changed.

Based on the available evidence, the review found that the number of shares an individual employee was entitled to receive and/or the exercise price was not determined with finality at the stated grant date on 53 tested grant dates, and we should have used a later date as the measurement date. The principal reasons for the stated grant date not qualifying as the measurement date under APB 25 include:

- certain listings of grantees, below officer level, were incomplete and added to or modified by stock option administration personnel after the grant was approved by the Compensation Committee;
- for certain grants where Compensation Committee approval was not considered perfunctory, the date a UWC document was sent to Compensation Committee members for approval was used as the stated grant date for some discretionary officer and director grants rather than the date the UWC was signed by all Compensation Committee members and therefore became effective;
- the Stock Option Review Team was unable to locate contemporaneous documentation of some director and officer, broadbase, new hire, and other merit grants.

During the review the Company also discovered a stock option grant to a former officer that was modified in 1998 in connection with his termination of employment. This change was never included in the Company's stock option grant records and the additional compensation expense resulting from the change in the option's terms (approximately $1.2 million) was not recorded previously. This discovery is consistent with the Stock Option Review Team's finding that in certain instances there was a lack of formal documentation in the stock option granting process and/or expected documentation is missing from the stock option administration files. In addition, the Stock Option Review Team found that, in many instances, there was a lack of self–authenticating evidence to corroborate that cash exercises were contemporaneous. As a result, the findings on the issue of backdating of cash exercises were inconclusive.

We are restating our consolidated financial statements to recognize additional non–cash stock–based compensation expense arising from using corrected measurement dates for certain stock option grants made during the years 2000 through 2005 and to reflect the modification of the 1998 grant described above. Consistent with our historical accounting policy this additional stock–based compensation expense is being recognized on an accelerated basis by treating each vesting tranche as a separate stock option grant (graded vesting).

Our accounting for stock–based compensation changed to a fair value based method in 2006 when, as required by accounting standards, we ceased accounting for stock–based compensation under the intrinsic value method pursuant to APB 25 and began accounting for stock–based compensation under Statement of Financial Accounting Standards 123(R) *Share–Based Payments* ("SFAS 123(R)"). Under this method all stock option grants have a fair value determined using an option pricing model, and such fair value is used to recognize non–cash stock–based compensation expense. We restated our unaudited condensed consolidated financial statements for the first and second fiscal quarters of 2006, included in Exhibit 99.1 in our Annual Report on Form 10–K for the year ended Decemer 31, 2006 (and as reflected in our results for the three and nine months ended September 30, 2006 included in this Form 10–Q) to recognize changes in non–cash stock–based compensation expense that arose from a re–determination of the fair value of stock options granted in 2005 and prior where the Governance Committee's review resulted in a corrected measurement date. By January 1, 2006, of the 17.9 million options granted in 2000 – 2005 where corrections were made to the measurement dates in the Stock Option Review, 4.4 million options with corrected measurement dates granted in 2000 and 2001 had fully vested. Therefore, the fair values of the outstanding and unvested portion of the remaining 13.5 million stock options granted in 2002–2005 with incorrect measurement dates were recalculated. We are also recording additional non–cash stock–based compensation expense in the first two quarters of 2006 arising from correcting the measurement date for stock option grants to three individuals in this period. We recognize stock compensation expense on a straight–line basis under SFAS 123(R).

Those stock option grants with corrected measurement dates have also been restated using the fair value based measurement principles of Statement of Financial Accounting Standards 123 *Accounting for Stock–Based Compensation* ("SFAS 123") to present, in Note 2, "Restatement of Financial Statements" of Notes to Consolidated Financial Statements contained in Item 8 of our Annual Report on Form 10–K for the year ended December 31, 2006, the pro forma effect on stock–based compensation expense, net income (loss), and earnings (loss) per share amounts in 2004 and 2005 of using the fair value based method to determine stock–based compensation expense rather than using APB 25's intrinsic value method. Such disclosure is required in financial statements for periods prior to the adoption of SFAS 123(R).

In addition to restating the consolidated financial statements in response to the Governance Committee's findings, we are recording additional non–cash adjustments to account for the modification in 1998 of a stock option grant to a former officer in connection with his termination of employment and to record in the first two quarters of 2006 corrections relating to accounting for performance related stock options and restricted stock grants, all of which were previously identified and considered immaterial.

Correcting the measurement date for previously granted stock options in some cases results in additional taxable income to employees on which additional payroll taxes are due from the employees as well as us. We have provided for all additional payroll taxes plus related penalties and interest arising from the restatement of stock–based compensation, including amounts otherwise payable by stock option recipients, and our restated financial statements include an accrual in all affected years of approximately $1.5 million for all estimated payroll tax related expenses.

The corrections for the stock option restatement are to increase (reduce) previously reported non–cash compensation expense, payroll taxes, income taxes and net income by the following amounts (in thousands of dollars):

Year ended December 31,	Non–cash stock compensation	Payroll taxes	Income taxes	Net income
1998	$ 1,244	$ —	$ (448)	$ (796)
1999	—	—	—	—
2000	556	—	(104)	(452)
2001	4,870	—	(942)	(3,928)
2002	8,110	—	(1,550)	(6,560)
2003	12,470	900	(2,281)	(11,089)
Totals through December 31, 2003	27,250	900	(5,325)	(22,825)
2004	(410)	541	250	(381)
2005	(1,290)	60	4,083	(2,853)
2000–2005 Total	25,550	1,501	(992)	(26,059)
2006 quarter ended				
March 31	662	9	—	(671)
June 30	504	6	—	(510)
	$ 26,716	$ 1,516	$ (992)	$ (27,240)

The Governance Committee's review found 17.9 million stock options of the 28.8 million options granted on our Common Stock during 2000 through 2005 had incorrect measurement dates. Using the corrected measurement dates, 7.6 million stock options had exercise prices that exceeded the closing price of our Common Stock and therefore had no intrinsic value to be accounted for under APB 25, and 10.3 million stock options had intrinsic value because their exercise prices were below the closing price of our Common Stock. These 10.3 million stock options resulted in an increase in additional non–cash stock–based compensation expense of $24.3 million, and an additional $1.5 million of payroll tax related expenses during 2000–2005 partially offset by $0.5 million of income tax benefit as shown in the above table. Of the 10.3 million stock options resulting in additional non–cash stock–based compensation expense, 2.0 million options were granted to officers and directors and resulted in $6.1 million of additional non–cash stock–based compensation expense.

The total effect of the stock option restatement and the amounts for 2006, as shown in the above table, have been reflected in the September 30, 2006 financial statements. As a result of this restatement, net income decreased by $3.7 million and $2.6 million, respectively, for the three and nine months ended September 30, 2005.

Upon completing its review, the Governance Committee concluded it found no evidence of intent to manipulate the Company's operating results or financial statements. A key finding of the Governance Committee was that there were deficiencies with the process by which stock options were granted during the period from our initial public offering in 2000 through at least 2005, which resulted in accounting errors. The Governance Committee concluded that certain members of management bear varying degrees of responsibility for the deficiencies in the process by which options were granted. The Governance Committee's review also concluded that none of the current or former employees or directors of the Company engaged in intentional wrongdoing.

In determining the above restatement amounts, management used all reasonably available relevant information to form conclusions it believes are reasonable as to the most likely option granting actions that occurred, the dates when such actions occurred, and the determination of grant dates for financial accounting purposes based on when the requirements of the accounting standards were met. In light of significant judgment used in establishing revised measurement dates, alternative approaches to those used by the Stock Option Review Team and management could have resulted in different compensation charges than those recorded in the restatement. The Stock Option Review Team and management considered various alternatives throughout the course of the review and restatement, and management believes the approaches used were the most appropriate in the circumstances, and the choices of measurement dates used in our review of stock option grant accounting and restatement of our financial statements were reasonable and appropriate in our circumstances.

Summary of Restatement Amounts

The following table presents the decrease in net earnings from the restatement for each restated year:

Year ended December 31,	Net income (loss), as previously reported	Restatement adjustments (in thousands) (Decrease) Increase: China Sales	Stock Options	Total	Net income (loss), as restated
1998		$ —	$ (796)	$ (796)	
1999		—	—	—	
2000		(4,781)	(452)	(5,233)	
2001		(5,779)	(3,928)	(9,707)	
2002	$ 107,862	(19,697)	(6,560)	(26,257)	$ 81,605
2003	$ 209,856	(6,382)	(11,089)	(17,471)	$ 192,385
Totals through December 31, 2003		(36,639)	(22,825)	(59,464)	
2004	$ 69,824	(18,594)	(381)	(18,975)	$ 50,849
2005	$ (487,359)	(42,433)	(2,853)	(45,286)	$ (532,645)
2000 – 2005 Total		(97,666)	(26,059)	(123,725)	
2006 quarter ended					
2006 Q1		1,360	(671)	689	
2006 Q2		(371)	(510)	(881)	
		$ (96,677)	$ (27,240)	$ (123,917)	

The effect these corrections on diluted earnings (loss) per share for 2002 to 2005 are as follows:

Year ended December 31,	Diluted earnings (loss) per share, as previously reported	Restatement amounts: China sales	Stock options	Total restatement	Diluted earnings (loss) per share, as restated
2002	0.94	(0.17)	(0.06)	(0.23)	0.71
2003	1.70	(0.05)	(0.09)	(0.14)	1.56
2004	0.54	(0.14)	(0.00)	(0.14)	0.40
2005	(4.16)	(0.36)	(0.03)	(0.39)	(4.55)

The cumulative effect on stockholders' equity at December 31, 2003 from the above corrections is as follows (in thousands):

Increase (decrease) in paid–in capital and deferred stock compensation:	
Values assigned to stock options	$ 27,250
Reduction of previously recorded income tax benefits from stock options	(1,278)
Net increase in paid–in capital and deferred stock compensation	25,972
(Increase) decrease in accumulated deficit:	
Revenue and related cost of sales deferral for China system sales	(36,639)
Additional non–cash compensation expense from stock options	(27,250)
Payroll taxes for values assigned to stock options	(900)
Income tax benefit from additional compensation and payroll tax expense	5,325
Net increase in accumulated deficit	(59,464)
Net decrease in stockholders' equity at December 31, 2003	$ (33,492)

In restating the previously issued financial statements for the investigations discussed above, we also corrected other previously reported amounts. It corrected the reporting of $7.2 million and $62.7 million, respectively, of net sales to certain third party resellers and $7.7 million and $24.6 million, respectively, of associated cost of net sales for the three and nine months ended September 30, 2005 to classify these amounts as related party net sales and related party cost of net sales classifications, respectively, because in 2006 we determined that sales to these entities were, in substance, sales to a significant shareholder, SOFTBANK CORP. The classification of the accounts receivable from these sales was similarly changed to include them in accounts receivable from related parties in the September 30, 2005 consolidated balance sheet.

ALL AMOUNTS IN THE FOLLOWING SECTIONS OF THIS MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, EXCEPT THOSE IDENTIFIED "AS PREVIOUSLY REPORTED" IN TABLES WITHIN THE QUARTERLY DATA (UNAUDITED), AS RESTATED CAPTION, REFLECT THE EFFECTS OF THE RESTATEMENT OF OUR FINANCIAL STATEMENTS TO CORRECT OUR REVENUE RECOGNITION FOR CERTAIN SALES CONTRACTS IN CHINA AND OUR HISTORICAL STOCK OPTION ACCOUNTING, AS WELL AS CERTAIN 2005 SALES, COST OF SALES AND ACCOUNTS RECEIVABLES AMOUNTS DISCOVERED TO BE RELATED PARTY TRANSACTIONS AND THE CORRECTION OF THE CLASSIFICATION OF A TIME DEPOSIT FROM CASH TO SHORT–TERM INVESTMENTS IN THE FIRST TWO QUARTERS OF 2006.

Late SEC Filings and NASDAQ Delisting Proceedings

As a result of the Nominating and Corporate Governance's Committee's review of our historical stock option accounting and the resulting restatements, we did not timely file our Quarterly Report on Form 10–Q for the quarter ended September 30, 2006 ("Q3 2006 Form 10–Q"), our Annual Report on Form 10–K for the fiscal year ended December 31, 2006 ("2006 Form 10–K"), and our Quarterly Report on Form 10–Q for the quarter ended March 31, 2007 ("Q1 2007 Form 10–Q") with the Securities and Exchange Commission. In addition, as a result of the Audit Committee's review of certain historical sales contracts in China, we did not timely file our Quarterly Report on Form 10–Q for the quarter ended June 30, 2007 ("Q2 2007 Form 10–Q") with the Securities and Exchange Commission.

In connection with our failure to timely file our periodic reports, we received four NASDAQ Staff Determination letters, dated November 15, 2006, March 7, 2007, May 16, 2007 and August 13, 2007, respectively, stating that, as a result of each of these non–timely filings, we were not in compliance with the requirements of Marketplace Rule 4310(c)(14) and, therefore, our stock was subject to delisting from the NASDAQ Stock Market. We appealed the November 15, 2006 determination to the NASDAQ Listing Qualifications Panel (the "Panel") and were granted a conditional extension to our request for continued listing until April 16, 2007. On April 17, 2007, the Panel extended the deadline for filing our Q3 2006 Form 10–Q to May 14, 2007. The Panel also extended the deadline for filing our 2006 Form 10–K until July 16, 2007.

On May 2, 2007, we asked the NASDAQ Listing and Hearing Review Council ("Listing Council") to review the April 17, 2007 decision of the Panel. On May 14, 2007, the Listing Council called the Panel's decision for review and requested that we provide an update on our efforts to file our delinquent filings. We have continued and continue to comply with that request. In addition, the Listing Council stayed the Panel's decision that required us to file our Q3 2006 Form 10–Q by May 14, 2007, and to file our 2006 Form 10–K by July 16, 2007. On August 23, 2007, the Listing Council granted the Company an extension until October 22, 2007 to file our delinquent periodic reports and restatements. As of the date of the filing of this Form 10–Q (which is filed concurrently with our 2006 Form 10–K), we will have two periodic reports still outstanding, our Q1 2007 Form 10–Q and our Q2 2007 Form 10–Q. We expect to be able to complete the filing of our outstanding reports as soon as practicable.

EXECUTIVE SUMMARY

We design, manufacture and sell telecommunications infrastructure, handsets and customer premise equipment and provide services associated with their installation, operation, and maintenance. Our products are sold primarily to telecommunications service providers or operators. We sell an extensive range of products that are designed to enable voice, data and video services for our operator customers and consumers around the world. While historically the vast majority of our sales have been to service providers in China, we have expanded our focus to build a global presence and currently sell our products in several other established and emerging growth markets, which include North America, Japan, India, Central and Latin America, Europe, the Middle East, Africa and Southeast and North Asia.

We differentiate ourselves with products designed to reduce network complexity, integrate high performance capabilities and allow a simple transition to next generation networks. We design our products to facilitate cost–effective and efficient deployment, maintenance and upgrades.

As of September 30, 2006 the Company was structured across four key operating units:

1. Network Solutions: Our Network Solutions operating unit provides its products and services through two reporting segments; Wireless Infrastructure and Broadband Infrastructure. Our Wireless Infrastructure segment designs, builds and sells software and hardware products that enable end users, or subscribers, to send and receive voice and data communication in either a fixed or mobile environment by using wireless devices. Our Broadband Infrastructure segment designs, builds and sells software and hardware products that enable end users to access high–speed, cost effective fixed data, voice and media communication;
2. Personal Communications Division: Our Personal Communications Division ("PCD") markets, sells and supports handsets other than PAS handsets for markets other than China. Most of our handset sales prior to 2006 were designed and built by other manufacturers, but beginning in 2006 and beyond future sales will include more products built by our Handsets segment;
3. Handsets: Our Handsets segment designs, builds and sells consumer devices that allow customers to access wireless services. Revenues from worldwide PAS handsets and all handset revenues within China are included in this segment; and
4. Services: Our Services segment provides service and support for Wireless Infrastructure and Broadband Infrastructure customers in the areas of planning, deployment, operations and ongoing maintenance.

Our products within each of these categories, excluding services, include multiple hardware and software subsystems that can be offered in various combinations to suit individual carrier needs. Our system products are based on widely adopted global communications standards and are designed to allow service providers to quickly and cost–efficiently integrate our systems into their existing networks and deploy our systems in new broadband, IP and wireless network rollouts. Our products are also designed for quick and cost–effective transition to future network technologies, enabling our customers to make the best use of their existing infrastructure.

Our largest market for the nine months ended September 30, 2006 and the year ended December 31, 2005 was the United States of America, representing 54% and 46% of sales, respectively. Prior to 2005, the majority of our sales were to service providers in China. This shift in market concentration and revenue is due to the combination of China's continued slow–down in its economy since the fourth quarter of 2004 and our ability to capture growth opportunities internationally as well as the incremental sales contributed by PCD subsequent to its acquisition in November 2004.

China has been one of our largest markets and we believe that it will continue to be an important market for our current and future technologies and development for the foreseeable future. However, we have also experienced a maturation of our PAS market in China resulting in our need to have a more diversified product and customer base. We also believe sales generated from China, as a percentage of total sales, may continue to decline as we continue to grow internationally.

We use subscriber growth statistics to gauge future inventory purchasing requirements as well as to forecast our anticipated revenue growth. We expect this subscriber growth to continue throughout 2006 as China's teledensity rates, or the number of telephones per person in a region, remain low in comparison to that of developed countries.

The number of competitors for communications access and switching systems and handsets in China has grown in line with China's telecommunications market expansion. This growth has led to competitive pricing pressure, causing average selling prices to decrease during the nine months ended September 30, 2006 relative to those in the comparative period in 2005. Our gross profit as a percentage of sales in both our wireless infrastructure and handset product lines have improved despite the decline in sales prices as a result of improved product cost management. We expect gross profit as a percentage of sales to decline during the remainder of the year as cost reduction measures are not likely to keep pace with price reductions.

We strive to develop products with more advanced features and to enhance the features of our existing products, which, we believe, will enable us to offer our customers more advanced products at higher average selling prices than otherwise would be possible in the future.

Over the past few years, we have undertaken a significant globalization program and we intend to continue to expand our global sales outside of China in the current year. As we expand, we will continue to improve our internal supply chain and inventory management processes to ensure timely deliveries. We will also continue to implement and enhance our administrative infrastructure to assist with our growth and globalization transformation.

On October 2, 2007, our Board of Directors approved a restructuring plan (the "Plan") to reduce operating costs, which includes a worldwide reduction in force of aproximately 11% of the Company's headcount, or approximately 700 employees. The workforce reduction will be based primarily in the United States and China and, to a lesser degree, other international locations. Management expects the Plan to be completed in the fourth quarter of fiscal year 2007. We expect to incur a restructuring charge in connection with the Plan of approximately $10 million, comprised largely of cash payments associated with one–time severance benefits, with the majority of the charge to be taken in the fourth quarter of 2007. In addition, the Company expects to realize annual cost savings in salary and compensation related expenses of approximately $21 million on an annualized basis.

We will continue our efforts to evaluate certain operations and will actively pursue opportunities to divest additional non–core assets and may incur additional costs associated with future actions to further align our business operations and streamline our business processes.

KEY TRANSACTIONS

Marvell Technology Group Ltd.

In February 2006, we sold substantially all of the assets and selected liabilities of our semiconductor design business division to Marvell Technology Group Ltd. ("Marvell"). We received $20.0 million in cash, net of $0.6 million of transaction costs, and an additional $4.3 million in cash in August 2007. At September 30 2006, an additional $16.0 million was receivable from Marvell as a result of achieving certain defined milestones. We received the $16.0 million cash payment in October 2006. The assets sold include the assets related to the prior acquisition of Advanced Communications Devices Corporation in 2001, and other system–on–chip semiconductors. In connection with the sale of assets, we have entered into a supply agreement with Marvell to purchase chipsets for our handset products over the next five years. These chipsets will be included in certain handset products designed and manufactured by the Company.

We recognized a $12.3 million gain on sale of assets during the three months ended September 30, 2006. The gain was determined based upon total net proceeds less the net book value of assets sold of $2.9 million and the value of the supply agreement of $20.2 million. The value allocated to the supply agreement is included in other current and long–term liabilities and is being amortized in proportion to the quantities of chipsets purchased under the supply agreement over the next five years. As of September 30, 2006, approximately $1.1 million has been amortized against cost of sales.

Stock–based Compensation

On January 1, 2006, we adopted the provisions of, and account for stock–based compensation in accordance with, Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 123—revised 2004 ("SFAS 123(R)"), "Share–Based Payment." We elected the modified–prospective method, under which prior periods are not revised for comparative purposes. Under the fair value recognition provisions of this statement, stock–based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight–line basis over the requisite service period, which is the vesting period.

We currently use the Black–Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan shares. The determination of the fair value of stock–based payment awards on the date of grant using an option–pricing model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk–free interest rate and expected dividends.

We estimate the expected term of options granted based upon our historical exercise and cancellation data for vested options. We estimate the volatility of our common stock by using historical volatility as management believes it is more representative of future stock price trends than implied volatility due to the relatively small number of actively traded options on our common stock available to determine implied volatility. We base the risk free interest rate that we use in the option pricing model on U.S. Treasury zero–coupon issues with remaining terms similar to the expected term on the options. We do not anticipate paying any cash dividends in the foreseeable future and therefore use an expected dividend yield of zero in the option pricing model. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from these estimates. We use historical data to estimate pre–vesting option forfeitures and record stock–based compensation expense only for those awards that are expected to vest. All share based payment awards are amortized on a straight–line basis over the requisite service periods of the awards, which are generally the vesting periods.

If factors change and we employ different assumptions for estimating stock–based compensation expense in future periods or if we decide to use a different valuation model, the future periods may differ significantly from what we have recorded in the current period and could materially affect our operating income, net income and net income per share.

The Black–Scholes option–pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics not present in our option grants and employee stock purchase plan shares. Existing valuation models, including the Black–Scholes and lattice binomial models, may not provide reliable measures of the fair values of our stock based compensation. Consequently, there is a risk that our estimates of the fair values of our stock–based compensation awards on the grant dates may bear little resemblance to the actual values realized upon the exercise, expiration, early termination or forfeiture of those stock–based payments in the future. Certain stock–based payments, such as employee stock options, may expire worthless or otherwise result in zero intrinsic value as compared to the fair values originally estimated on the grant date and reported in our financial statements. Alternatively, value may be realized from these instruments that are significantly higher than the fair values originally estimated on the grant date and reported in our financial statements. There is not currently a market–based mechanism or other practical application to verify the reliability and accuracy of the estimates stemming from these valuation models, nor is there a means to compare and adjust the estimates to actual values.

The guidance in SFAS 123(R) is relatively new. The application of these principles may be subject to further interpretation and refinement over time. There are significant differences among valuation models, and there is a possibility that we will adopt different valuation models in the future. This may result in a lack of consistency in future periods and materially affect the fair value estimate of stock–based payments. It may also result in a lack of comparability with other companies that use different models, methods and assumptions.

Strategic Alliance Agreement

On September 25, 2006, we entered into a Strategic Alliance Agreement with Pantech & Curitel Communications, Inc. ("Pantech"). Pursuant to the Agreement, Pantech appointed us as its exclusive distributor for Pantech's CDMA handsets and related products (the "CDMA Units") in North America, Central America and South America with the exception of Brazil (the "Territory"), for a period of three (3) years.

Under the terms of the Agreement, we may, upon satisfaction of certain terms and conditions of the Agreement, purchase from Pantech an aggregate of up to thirty million (30,000,000) CDMA Units over a three (3) year period, starting on October 1, 2006, for distribution in the Territory.

TRANSACTIONS WITH RELATED PARTIES AND OTHER INFORMATION

Softbank and affiliates

We recognized revenue of $29.7 million and $112.0 million for the three and nine months ended September 30, 2006, respectively, and revenue of $13.0 million and $394.6 million during the three and nine months ended September 30, 2005, as restated, respectively, with respect to sales of telecommunications equipment to affiliates of SOFTBANK CORP. ("Softbank"), a significant stockholder of the Company. In the third quarter of 2006, we determined that certain sales to third party resellers are, in substance, sales to Softbank and therefore, we have included these amounts in related party sales. Softbank offers asynchronous digital subscriber line ("ADSL") coverage throughout Japan, which is marketed under the name "YAHOO! BB." We support Softbank's fiber–to–the–home service through sales of our carrier class Gigabit Ethernet Passive Optical Network ("GEPON") product as well as our multi–service optical transport product ("NetRing™"). In addition, we support Softbank's new internet protocol television ("IPTV"), through sales of our RollingStream™ product. Included in revenue for the nine

months ended September 30, 2006 is a fee of $31.2 million charged for the cancellation of orders for broadband products and $10.0 million charged for the cancellation of orders for wireless infrastructure products.

Included in accounts receivable at September 30, 2006 and December 31, 2005 were $35.2 million and $83.4 million, respectively, related to these agreements. Sales to Softbank include a three–year service period and a penalty clause if product failure rates exceed a certain level over a seven–year period. There were $13.3 million and $19.6 million included in long term deferred revenue with respect to these agreements at September 30, 2006 and December 31, 2005, respectively. Additionally, there were $11.2 million and $8.0 million included in current deferred revenue at September 30, 2006 and December 31, 2005, respectively. As of September 30, 2006 there were no customer advances, and as of December 31, 2005, there were $5.4 million included in customer advances related to Softbank agreements. We have an outstanding purchase commitment with Softbank to purchase the component parts. Purchases from Softbank totaled $1.0 million and $1.4 million during the three and nine months ended September 30, 2006, respectively. There were no purchases from Softbank during the three and nine months ended September 30, 2005, respectively. We had an outstanding accounts payable balance of $2.7 million with Softbank as of September 30, 2006.

During August 2004, we entered into several agreements with Japan Telecom Co., Ltd ("JT"), a wholly owned subsidiary of Softbank. These agreements relate to the sale of *i*AN–8000 equipment with specified value and delivery dates, as well as an oral agreement which subsequently converted into specific service contracts to manage a sales promotional program for JT. We have determined that the service activities revenue should be recorded net of expected promotional spending.

Because we had not provided these activities in the past and could not estimate the fair value of these services, we determined under the guidance of SAB 104 that all revenue related to these agreements could not be recognized until all goods and services were delivered. We had delivered and received final acceptance for all equipment contemplated under these agreements in the quarter ended March 31, 2005.

The promotional services discussed above involved contracting with third party promotional vendors, who in turn, facilitated the marketing and subscriber recruitment for the JT fiber–to–the–home program. During the fourth quarter of 2004, we determined that we would end our involvement with the JT promotional program after completion of the contract discussed above. Accordingly, late in the fourth quarter of 2004 and during the first quarter of 2005, we either cancelled or assigned to another party all third party contracts with promotional vendors related to the JT contract. Such termination or assignment of all third party promotional agreements, as well as effective satisfaction of our obligations with JT under such agreements, satisfied the revenue recognition criteria for these agreements and as such, the net value of the promotional services and the value of equipment delivered, which totaled $205.4 million, was reported in the quarter ended March 31, 2005.

We also entered into an agreement with JT during the third quarter of 2004 to supply chassis equipment. The equipment shipped under this agreement is considered linked to the *i*AN–8000 sale noted above and as such, was also deferred until the completion of the abovementioned promotional activities. The revenue recognition criteria related to the sale of the *i*AN–8000 equipment was satisfied in the first quarter of 2005 and as such, the revenue related to the chassis sale of $66.5 million was reported in the quarter ended March 31, 2005.

During the three and nine months ended September 30, 2006, sales to Softbank included $2.0 million and $5.2 million, respectively, and during the three and nine months ended September 30, 2005, sales to Softbank included $2.5 million and $278.6 million, respectively, with regards to telecommunications equipment and services sold to JT.

In June 2006, we purchased advertising space and season tickets totaling $0.2 million from a sports franchise owned by Softbank.

On July 17, 2003, we entered into a Mezzanine Loan Agreement with BB Modem Rental PLC ("BB Modem"), an affiliate of Softbank. Under the terms of the agreement, we loaned BB Modem $10.1 million at an effective interest rate of 12.01% per annum, for the purpose of investing in a portfolio of ADSL modems and associated modem rental agreements, from Softbank. Softbank will continue to service such modems and modem rental agreements. Our loan is subordinated to certain senior lenders of BB Modem, and repayments are payable to the Company over a 42–month period through January 31, 2007, with a substantial portion of the principal amount of the loan repaid during the last 16 months of this period. During the three and nine months ended September 30, 2006, we recorded $0.1 million and $0.5 million, respectively, in interest income in respect to this loan. The loan receivable at September 30, 2006 and December 31, 2005 was approximately $2.4 million and $9.0 million, respectively and is included in other current assets. The note receivable was paid in full in January 2007.

As of September 30, 2006, Softbank beneficially owned approximately 12.1% of our outstanding stock.

Acoustek Int'l, Inc.

In 2005 and 2006, we received consulting services from Acoustek Int'l Corp. ("Acoustek"), which employed Minnie Huang, spouse of William Huang, our former Senior Vice President and Chief Technology Officer. Mr. Haung's employment with the Company terminated on December 31, 2006. We paid to Acoustek $0.1 million during each of the nine months ended September 30, 2006 and 2005 for consulting services, and a negligible amount during the three months ended September 30, 2006 and 2005.

Audiovox

One of our officers also serves as a director for Audiovox Corporation ("Audiovox"). During the three and nine months ended September 30, 2006, we paid approximately $0.4 million and $1.1 million, respectively, of IT services from Audiovox.

Cellon

In September 2001, we invested $2.0 million in Cellon International Holdings Corporation ("Cellon") and made additional investments of $3.0 million each in Cellon in April and December 2002. Cellon designs wireless terminals and related technology for handset manufacturers and private distributors. In November 2005, we entered into an agreement with Cellon under which we received consideration in the form of preferred stock and warrants of Cellon valued at $5.5 million in exchange for the transfer of fixed assets with a net book value of $3.0 million, a facilities lease and a workforce in place consisting of 156 employees. This transaction was completed on May 31, 2006 and a gain on sale of assets of $2.5 million was recorded in other income. As of September 30, 2006, with the additional shares obtained in the purchase transaction, we had an 11% ownership interest in Cellon. This investment is accounted for under the cost method, and its carrying value has been evaluated for possible impairment based on the achievement of business objectives and milestones, the financial condition and prospects of the Company and other relevant factors.

In November 2005, we entered into a Development Service Agreement with Cellon in which $5.0 million was prepaid in exchange for future product development. Approximately $0.7 million and $2.0 million of the prepaid amount has been used in the three and nine months ended September 30, 2006 as payments for design services. We may also use the $5.0 million prepayment in satisfaction of royalties Cellon may earn from sales by us of products Cellon designs under the Development Services Agreement. This agreement also obligates Cellon to pay us a royalty if certain technology shared by us to Cellon is used in products developed and sold to customers other than us through November 2007.

In the fourth quarter of 2006, we reviewed our long–term investment in Cellon. The review included, but was not limited to, a review of Cellon's cash position, recent financing activities, financing needs, earnings/revenue outlook, operational performance, management/ownership changes, and competition. Based on the deterioration of Cellon's financial condition that resulted from significant adverse changes in Cellon's business in the fourth quarter of 2006, we determined that the carrying value of the investment was at an amount above the fair value of the investment, and the decline was other–than temporary. As of December 31, 2006, we recorded a $13.5 million other–than–temporary impairment charge for this investment in other income, net and recorded an operating expense of $3.0 million to write–off a prepayment to Cellon. On June 18, 2007, a meeting of Cellon's shareholders was held where a resolution was passed to place Cellon in voluntary liquidation.

As of September 30, 2006 we had an accounts payable balance of $0.6 million, and a minimal accounts receivable balance.

Fiberxon, Ltd.

We have an outstanding purchase commitment with Fiberxon, in which we have a 7% ownership interest, to purchase component parts for optical networking products. Purchases from Fiberxon totaled $1.7 million and $2.1 million during the three and nine ended September 30, 2006, respectively. Purchases from Fiberxon totaled $0.5million and $8.6 million during the three and nine months ended September 30, 2005, respectively, and we had $1.1 million and $0.3 million in accounts payable to Fiberxon at September 30, 2006 and December 31, 2005, respectively. As of September 30, 2006, the Company had $0.6 million of open purchase commitments to Fiberxon.

GCT Semiconductor, Inc.

We have an outstanding purchase commitment with GCT Semiconductor, Inc. ("GCT"), in which we have a 2% ownership interest, to purchase component parts. Purchases from GCT for the three and nine months ended September 30, 2006 were $0.5 million and $4.9 million, respectively. As of September 30, 2006, we had a $0.5 million accounts payable balance with GCT. We had purchases of $0.3 million for the nine months ended September 30, 2005.

Global Asia Partners L.P.

Global Asia Partners L.P. is a venture capital fund formed to make private equity investments in private or pre–IPO technology and telecommunications companies in Asia. The general partner of this fund is also one of our sales agents. Between June 2002 and April 2005, we invested a total of $2.6 million in the fund. As of September 30, 2006 and December 31, 2005, we had 49% of the fund's outstanding partnership units. We had a commitment to invest up to a maximum of $5.0 million. As the result of a reorganization of capital contributions by the partners, reached in April 2005, our capital contribution of $0.5 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re–invest up to $2.5 million that otherwise would have been available to us as future distributions. There were no cash distributions during the three or nine months ended September 30, 2006 or 2005.

Immenstar

We have an outstanding purchase commitment with Immenstar, in which we own Series A preferred stock, to purchase component parts. Purchases from Immenstar totaled $1.3 million and $1.8 million during the three and nine months ended September 30, 2006, respectively. As of September 30, 2006, the Company had a $0.3 million accounts payable balance and $4.5 million of open purchase commitments to Immenstar.

Matsushita Joint Venture

In July 2002, we entered into a joint venture agreement with Matsushita Communication Industrial Co., Ltd. to jointly design and develop, manufacture and sell telecommunication products. We had a 49% ownership interest in the joint venture company. As of December 31, 2005, we had a receivable of $0.1 million. In December 2005, the partners agreed to dissolve the joint venture, which was completed by June 30, 2006.

MDC Holding, Ltd.

We had an outstanding accounts receivable balance with MDC Holding, Inc. ("MDC") related to a PAS system purchase of $1.3 million at September 30, 2006. There was no accounts receivable balance at December 31, 2005. Certain of our employees were shareholders of MDC as of September 30, 2006. MDC is in the business of providing value–added services, such as short message, voicemail or ring–tone services for PAS telecom networks.

ORG, Inc.

We have a 49% ownership in Global Asia Partners L.P. which in turn is a significant shareholder in ORG, Inc. During the three and nine months ended September 30, 2006, we had sales of $1.4 million and $1.6 million to ORG, Inc. During the three and nine months ended September 30, 2005 we had sales of $0.3 million and $0.5 million, respectively, to ORG, Inc. We had $1.3 million and $0.2 million receivable as of September 30, 2006 and December 31, 2005, respectively.

Starcom Products, Inc.

We obtain engineering consulting and employee placement services from Starcom Products, Inc. ("Starcom"), which is 31% owned by an individual related one of our former officers who was also a member of our Board of Directors. We obtained services amounted to $0.1 million and $0.6 million, respectively, from this entity in the three and nine months ended September 30, 2005. There were no such services performed during the three and nine months ended September 30, 2006.

Xalted Networks, Inc.

We received purchase orders from Xalted Networks, in which the Company owns preferred stock, totaling approximately $1.3 million in 2005 for telecommunications equipment that is for product not typically sold by us to other customers. We are charging a ten percent procurement fee to Xalted for obtaining and reselling these products. The equipment was delivered but revenue has not been recognized as the revenue recognition process had not been completed.

RESULTS OF OPERATIONS

As mentioned in the Executive Summary, we manage our business based principally upon product families of four operating units, (i) Network Solutions, which includes the Broadband Infrastructure and Wireless Infrastructure reporting segments, (ii) PCD, (iii) Handsets and (iv) Service. A summary of the financial results of each of the segments are as follows:

NET SALES

	Three months ended September 30, 2006	% Net sales	Three months ended September 30, 2005 (As restated)	% Net sales	Nine months ended September 30, 2006	% Net sales	Nine months ended September 30, 2005 (As restated)	% Net sales
				(in thousands)				
Net Sales by Segment								
Broadband Infrastructure	$ 50,754	8%	$ 31,018	5%	$ 152,774	9%	$ 414,148	19%
Wireless Infrastructure	110,299	18%	77,586	13%	331,997	19%	310,708	14%
Network Solutions	161,053	26%	108,604	18%	484,771	28%	724,856	33%
PCD	328,701	55%	363,637	61%	917,943	52%	1,021,452	47%
Handsets	93,163	16%	106,294	18%	299,266	17%	378,256	17%
Service	17,982	3%	18,900	3%	52,426	3%	65,454	3%
	$ 600,899	100%	$ 597,435	100%	$ 1,754,406	100%	$ 2,190,018	100%

	Three months ended September 30, 2006		Three months ended September 30, 2005 (As restated)		Nine months ended September 30, 2006		Nine months ended September 30, 2005 (As restated)	
				(in thousands)				
Sales by region								
United States	$ 328,433	54%	$ 359,164	60%	$ 924,548	53%	$ 987,223	45%
China	190,379	32%	175,410	29%	595,505	34%	660,821	30%
Japan	30,745	5%	13,635	2%	116,477	6%	398,694	18%
Other	51,342	9%	49,226	9%	117,876	7%	143,280	7%
Total Net Sales	$ 600,899	100%	$ 597,435	100%	$ 1,754,406	100%	$ 2,190,018	100%

Three months ended September 30, 2006 and 2005

Net sales increased by 1% to $600.9 million during the quarter ended September 30, 2006 compared to the same period in 2005. Net sales increased 48% in the Network Solutions segment, but sales declined in all other operating segments. The reported sales of the remaining segments were between 5% and 12% lower during the three months ended September 30, 2006 than the same period in the prior year. Broadband Infrastructure segment sales are concentrated with one customer, Softbank in Japan, and as such fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products as well as our PAS/iPAS based handsets in the China market continued to mature which resulted in lower unit demand offset by the sale of higher priced units. In our PCD operating segment, net sales decreased 10% during the three months ended September 30, 2006 from the comparable period in the prior year, due to a decline in the number of handsets sold, partially offset by an increase in our average price per unit. During 2005, the Company recorded restatement adjustments to defer $49.6 million of revenue as all conditions necessary for revenue recognition had not been achieved. Net sales in the nine months ended September 30, 2006 include approximately $16.5 million of the revenue deferred as part of the 2005 restatement; adjustments. For additional discussion of our business segments see "Segment Reporting."

Nine months ended September 30, 2006 and 2005

Net sales were $1,754.4 million in the nine months ended September 30, 2006, a decrease of 20% from $2,190.0 million in the corresponding period of 2005. The overall decrease in net sales was largely due to a decrease in sales in the Broadband Infrastructure segment of 63%, from the nine months ended September 30, 2005 compared to the same period ended September 30, 2006. Broadband Infrastructure segment sales during the nine months ended September 30, 2005 included one large transaction with Softbank totaling $271.9 million of revenue on certain agreements entered into with Japan Telecom primarily for iAN8000 product. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products and our PAS/iPAS based handsets in the China market continued to mature, which resulted in lower unit demand. This led to a decrease in our handset segment sales of 21%, respectively, from the nine months ended September 30, 2005 compared to the same period ended September 30, 2006. In our PCD operating segment, our unit sales and average price per unit declined during the nine months ended September 30, 2006 from the comparable period in the prior year, leading to a 10% decline in segment revenue. For additional discussion of our business segments see "Segment Reporting."

Net sales revenue by geography shifted in comparison to the corresponding period of 2005. Revenue derived from China accounted for approximately 34% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 30% in the corresponding period last year due to lower demand for PAS/iPAS products. Revenue derived from the United States accounted for approximately 53% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 45% in the corresponding period last year as PCD sales in the United States become proportionately bigger compared to total Company sales. Revenue from Japan accounted for approximately 6% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 18% for the comparable period in the prior year due to the completion of a large contract during 2005.

GROSS PROFIT

	Three months ended September 30,				Nine months ended September 30,			
	2006	Gross Profit %	2005 (As restated)	Gross Profit %	2006	Gross Profit %	2005 (As restated)	Gross Profit %
				(in thousands)				
Gross profit by Segment								
Broadband Infrastructure	$ (837)	(2)%	$ (13,875)	(45)%	$ 27,138	18%	$ 166,958	40%
Wireless Infrastructure	54,217	49%	16,332	21%	158,835	48%	77,661	25%
Network Solutions	53,380	33%	2,457	2%	185,973	38%	244,619	34%
PCD	(7,057)	(2)%	13,199	4%	19,653	2%	42,881	4%
Handsets	24,012	26%	13,633	13%	88,521	30%	48,972	13%
Service	4,466	25%	8,598	45%	13,395	26%	36,709	56%
	$ 74,801	12%	$ 37,887	6%	$ 307,542	18%	$ 373,181	17%

Cost of sales consists primarily of material and labor costs, including stock–based compensation, associated with manufacturing, assembly and testing of products, costs associated with installation and customer training, warranty costs, fees to agents, inventory provision and overhead. Cost of sales also includes import taxes and tariffs on components and assemblies. Some components and materials used in our products are purchased from a single supplier or a limited group of suppliers and, in some cases, are subject to our obtaining Chinese import permits and approvals. We also rely on third party manufacturers to manufacture and assemble most of our CDMA handsets.

Our gross profit has been affected by average selling prices, material costs, product mix, the impact of warranty charges and contract loss provisions as well as inventory reserves and release of deferred revenues and related cost pertaining to prior years. Our gross profit, as a percentage of net sales, varies among our product families. We expect that our overall gross profit, as a percentage of net sales, will fluctuate from period to period as a result of shifts in product mix, stage of product life cycle, anticipated decreases in average selling prices and our ability to reduce cost of sales.

Three months ended September 30, 2006 and 2005

Gross profit was $74.8 million, or 12% of net sales, in the three months ended September 30, 2006, compared to $37.9 million, or 6% of net sales in the corresponding quarter of 2005. The overall gross profit increased in real terms even though net sales remained relatively constant, due to significant increase in gross profit percentages in our Broadband Infrastructure, Wireless Infrastructure, and Handsets segments. For additional discussion of our business segments see "Segment Reporting."

Nine months ended September 30, 2006 and 2005

Gross profit was $307.5 million, or 18% of net sales, in the nine months ended September 30, 2006, compared to $373.2 million, or 17% of net sales in the corresponding period of 2005. While the total Company gross profit percentage remained relatively constant, Broadband Infrastructure gross profit dollars decreased $139.8 million due to a decline in sales of $261.4 million and a decrease in the gross profit percentage from 40% during the nine months ended September 30, 2005 to 18% in the corresponding period of 2006. As mentioned previously, revenue from the Broadband Infrastructure segment is concentrated with one customer in Japan and a significant contract was recognized as revenue during the first quarter of 2005. There was no similar–sized transaction in the Broadband Infrastructure segment during the nine months ended September 30, 2006. The decrease in gross profit resulting from the Broadband Infrastructure segment was partially offset by increased gross profit dollars resulting from improvement in gross profit percentages in the Wireless Infrastructure and Handset segments. For additional discussion of our business segments see "Segment Reporting."

OPERATING EXPENSES

The following table summarizes our operating expenses:

	Three months ended September 30,				Nine months ended September 30,			
	2006	% Net sales	2005 (As restated)	% Net sales	2006	% Net sales	2005 (As restated)	% Net sales
	(in thousands)							
Selling, general and administrative	$ 80,076	13%	$ 86,414	15%	$ 246,908	14%	$ 297,390	14%
Research and development	46,305	8%	60,817	10%	139,310	8%	192,297	8%
Amortization of intangible assets	4,821	1%	6,643	1%	14,567	1%	20,391	1%
Gain on the sale of semiconductor design assets	(12,291)	(2)%	—	0%	(12,291)	(1)%	—	0%
Impairment of long–lived assets	—	0%	218,094	37%	—	0%	218,094	10%
Restructuring costs	—	0%	3,378	0%	—	0%	18,505	1%
In–process research and development	—	0%	—	0%	—	0%	660	0%
Total operating expenses	$ 118,911	20%	$ 375,346	63%	$ 388,494	22%	$ 747,337	34%

Selling, general and administrative expenses ("SG&A") include compensation and benefits, professional fees, sales commissions, provision for doubtful accounts receivable and travel and entertainment costs. Research and development expenses consist primarily of compensation and benefits of employees engaged in research, design and development activities, costs of parts for prototypes, equipment depreciation and third party development expenses. We believe that continued and prudent investment in research and development is critical to our long–term success, and will aggressively evaluate appropriate investment levels. A portion of our costs are fixed and are difficult to quickly reduce in periods of lower sales.

SELLING, GENERAL AND ADMINISTRATIVE

Three months ended September 30, 2006 and 2005

Selling, general and administrative expenses decreased $6.3 million during the three months ended September 30, 2006 compared to the same period in 2005. The decrease in SG&A expenses was primarily due to a $14.7 million decrease in our provision for doubtful accounts compared to the same period in 2005. Days sales outstanding was 64 days at September 30, 2006 as compared to 86 days at September 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections in the three months ended September 30, 2006 relative to the comparable period in 2005. In addition, there were reductions in expenses due to expense controls. These cost savings were partially offset by a value added tax expense of $7.9 million resulting from an audit of our 2003 through 2005 tax years by China tax authorities.

Nine months ended September 30, 2006 and 2005.

SG&A expenses were $246.9 million and $297.4 million in the nine months ended September 30, 2006 and 2005, respectively. SG&A expenses as a percentage of net sales were 14% and 14% for the nine months ended September 30, 2006 and 2005, respectively. The decrease in SG&A expenses was primarily due to a $45.1 million decrease in our provision for doubtful accounts compared to the same period in 2005 resulting from cash collections on previously reserved receivables in China. Days sales outstanding was 69 days at September 30, 2006 as compared to 95 days at September 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections in the nine months ended September 30, 2006 relative to the comparable period in 2005. In addition, there were reductions in expenses due to expense controls. These cost savings was partially offset by a value added tax expense of $7.9 million resulting from an audit of our 2003 through 2005 tax years by China tax authorities.

RESEARCH AND DEVELOPMENT

Three months ended September 30, 2006 and 2005

Research and development ("R&D") expenses were $46.3 million, or 8% of net sales, in the three months ended September 30, 2006, compared to $60.8 million, or 10% of net sales in the corresponding period of 2005. The decrease of $14.5 million in absolute dollars of R&D expenses can be primarily attributed to the decreased headcount of approximately 778 employees resulting from restructuring activities and the transfer of engineers as part of the sale of ACD. Personnel related expenses decreased by $3.9 million and equipment, facility and depreciation cost decreased by $8.2 million as a result of restructuring and write down of R&D equipment.

Nine months ended September 30, 2006, and 2005

R&D expenses were $139.3 million and $192.3 million, or 8% and 8% of net sales, in the nine months ended September 30, 2006 and 2005, respectively. In absolute dollars, R&D expenses decreased by $53.0 million, primarily due to a decrease in equipment, facility and depreciation costs of $25.0 million as a result of restructuring and write–down of R&D equipment. Also, there was a decrease in personnel expenses, including payroll, payroll taxes and benefits totaling $13.8 million resulting from the decreased headcount as described above. In addition, the decrease in R&D expenses also can be attributed to a $7.1 million cost savings resulting from a decreased use of consultants.

AMORTIZATION OF INTANGIBLE ASSETS

Three and nine months ended September 30, 2006 and 2005

Amortization of intangible assets expenses was $4.8 million and $6.6 million, or 1% and 1% of net sales, in the three months ended September 30, 2006 and 2005, respectively. Amortization of intangible assets expenses were $14.6 million and $20.4 million, or 1% and 1% of net sales in the nine months ended September 30, 2006 and 2005, as restated, respectively. The decrease in the amortization of intangible assets for the three and nine months ended September 30, 2006 was due to several intangible assets being fully amortized during the preceding twelve months.

GAIN ON SALE OF SEMICONDUCTOR DESIGN ASSETS

Three months and nine months ended September 30, 2006

In February 2006, we sold substantially all of the assets and selected liabilities of our semiconductor design operations, including the assets related to the prior acquisition of Advanced Communications Devices Corporation to Marvell Technology Group Ltd. We recognized a $12.3 million gain on sale of these assets in the third quarter of 2006 upon achieving the defined milestones.

ASSET IMPAIRMENT

Three and nine months ended September 30, 2006 and 2005

In the third quarter of 2005, we determined that certain circumstances had changed sufficiently to indicate that the fair value of certain of our reporting units may be below their book values. As a result, we conducted an evaluation of our long–lived assets including goodwill, intangible assets, and certain property plant and equipment for impairment and recorded impairment charges.

Intangible assets classified as goodwill and those with indefinite lives are not amortized. Intangible assets with determinable lives are amortized over their estimated useful lives. We perform an annual impairment test of our goodwill as of November 1st of each year. We also test for impairment between annual tests if a "triggering" event occurs that may have the effect of reducing the fair value of a reporting unit below their respective carrying values. When conducting the goodwill impairment analysis, we calculate impairment charges based on the two–step test prescribed in SFAS 142, "Goodwill and Other Intangible Assets" ("SFAS 142") and using the estimated fair value of the respective reporting units. We use the present value of future cash flows from the respective reporting units to determine the estimated fair value of the reporting unit and the implied fair value of goodwill. We also test long–lived assets in all of our asset groups for potential impairment in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long–lived Assets." Our long–lived assets are tested for recoverability based on undiscounted cash flows, and if impaired, written down to fair value based on either discounted cash flows or appraised values.

Management held a series of planning meetings in September 2005 to assess the current business forecast for all reporting units. This assessment analyzed various factors including a reduction in the rate of growth of PAS subscribers in the third quarter, a delay of the expected granting of 3G licenses in China and Japan, challenges with product quality primarily in our Broadband reporting unit, a narrowing of our strategic focus related to our product offering and greater than expected revenue and margin decline due to continued pricing pressures for several of our key markets. Management concluded these factors combined represented a triggering event.

Due to the existence of the triggering event in September 2005, we determined that there were significant adverse changes in the business outlook which could indicate the carrying value of certain of our long lived assets groups may not be recoverable and could indicate the fair value of our reporting units may be below their fair value. As a result, we performed interim impairment tests on goodwill and certain other long lived tangible and intangible assets.

Goodwill:

We performed an impairment analysis pursuant to SFAS 142 as of September 30, 2005 for all of our reporting units. We compared the fair value of the reporting units to their carrying value. We determined the fair value of each reporting unit using both present value and comparable company techniques based, in part, upon an independent valuation. The fair values of the reporting units were reconciled to our overall market capitalization at September 30, 2005.

Based on the impairment assessment noted above, a goodwill impairment charge of $192.9 million was estimated and recorded during the three months ended September 30, 2005 to write off the full value of goodwill for the Wireless, Broadband, Handsets and PCD business units. The second step of the goodwill impairment test for Broadband and Handsets segments was completed in the third quarter and for the Wireless and PCD units was performed in the fourth quarter of 2005, which reaffirmed the estimate from the third quarter that the goodwill was fully impaired. As such, there was no adjustment from the amount previously recorded.

Long–lived Assets:

We also tested our long–lived assets in all of our asset groups for potential impairment during the third quarter of 2005 in accordance with SFAS 144, "Accounting for the Impairment or Disposal of Long–lived Assets." Based on this analysis, we determined that the undiscounted expected future cash flows for the broadband and handset asset groups were less than the carrying value of the net assets.

We determined the relative estimated fair value of tangible assets through a comparison of similar assets, and wherever practical, based on quoted market prices taking into consideration the asset type, age, condition, and physical location of the asset. As a result of this analysis, we recorded an impairment charge of $14.1 million for long–lived tangible assets related to the Broadband asset group and $9.4 million for long–lived tangible assets related to the Handset asset group.

In addition, we determined that the fair value of technology–related intangible assets within the Handset asset group as calculated using the discounted future cash flows was less than the carrying value of the net assets and as such, we recorded a net asset write–off of $1.7 million.

The following table summarizes the impairment charges incurred during 2005:

	Goodwill Impairment	Intangible Impairment	PP&E Impairment	Total
		(in thousands)		
Handsets	$ 89,337	$ 1,678	$ 9,417	$ 100,432
Wireless	55,670	—	—	55,670
PCD	24,712	—	—	24,712
Broadband	23,210	—	14,070	37,280
Total	$ 192,929	$ 1,678	$ 23,487	$ 218,094

There were no asset impairment charges recorded during the nine months ended September 30, 2006.

IN–PROCESS RESEARCH AND DEVELOPMENT

Nine months ended September 30, 2006 and 2005

The $0.7 million charges to in–process research and development ("IPR&D") for the nine months ended September 30, 2005, were related to our acquisition of Pedestal Networks. All charges to IPR&D were based, in part, upon independent valuations. In assessing IPR&D projects, we considered key product characteristics including each product's development stage at the acquisition date, each product's life cycle and each product's future prospects. We also considered the rate at which technology changes in the relevant industry, the industry's competitive environment and the economic market outlook. There have been no IPR&D costs in 2006.

RESTRUCTURING

Three and nine months ended September 30, 2006 and 2005

In the second quarter of the fiscal year 2005, we announced and initiated a restructuring plan to rationalize our cost structure in response to the decline in demand for certain of our products. In addition, the restructuring plan was designed to allow us to reduce break–even revenues for each product line, align investments with key growth opportunities and facilitate the process of globalization.

During the three months ended September 30, 2005, the Company incurred approximately $3.4 million in expenses in relation to the restructuring plan actions, consisting of $2.1 million related to severance payments and $1.2 million in asset impairments primarily related to the write–off of equipment and licenses associated with discontinued products.

During the nine months ended September 30, 2005, the Company incurred approximately $18.5 million in operating expenses in relation to the restructuring plan actions, primarily consisting of $9.8 million related to severance payments and $8.7 million in asset impairments primarily related to the impairment of equipment and licenses associated with discontinued products. Included in the restructuring costs of $18.5 million were non–cash charges of $7.6 million in asset impairments. We made cash payments of $10.5 million for severance and other benefits, and $1.1 million of accrued expenses. As part of the restructuring plan, during the nine months ended September 30, 2005 we recorded $5.5 million in inventory write–off which is associated with discontinued products. Restructuring expense related to the inventory write–off is included in cost of sales in the consolidated statements of operations.

During the fourth quarter of 2005, we incurred an additional $11.2 million in operating expenses in relation to the restructuring plans. As of December 31, 2005, approximately $1.2 million remained unpaid in accrued expenses, and as of September 30, 2006, approximately $0.3 million remained unpaid, primarily relating to remaining lease termination expenses. There was no restructuring cost recorded during the nine months ended September 30, 2006.

INTEREST INCOME

Three months ended September 30, 2006 and 2005

Interest income was $3.2 million and $1.7 million for the three months ended September 30, 2006 and 2005, respectively. Interest income was generated from cash and short–term investment balances were higher in the three months ended September 30, 2006 as compared to the corresponding period of 2005. The average interest rate on investments was 2.16% at September 30, 2006, an increase of 39% compared with the average interest rate of 1.55% at September 30, 2005.

Nine months ended September 30, 2006 and 2005

Interest income was $10.7 million and $4.5 million for the nine months ended September 30, 2006 and 2005, respectively. Interest income was generated from cash and short–term investment balances were higher in the nine months ended September 30, 2006 as compared to the corresponding period of 2005. The average interest rate on investments was 2.16% at September 30, 2006, an increase of 39% compared with the average interest rate 1.55% at September 30, 2005.

INTEREST EXPENSE

Three months ended September 30, 2006 and 2005

Interest expense was $2.6 million and $3.9 million for the three months ended September 30, 2006 and 2005, respectively. The decrease in interest expense for the three months ended September 30, 2006 was attributable to the decrease in short–term debt, which declined from approximately $226.4 million as of September 30, 2005 to approximately $105.0 million as of September 30, 2006.

Nine months ended September 30, 2006 and 2005

Interest expense was $9.3 million and $12.9 million for the nine months ended September 30, 2006 and 2005, respectively. The decrease in interest expense for the nine months ended September 30, 2006 was attributable to a decrease in short–term borrowings.

GAIN ON EXTINGUISHMENT OF DEBT

Three and nine months ended September 30, 2006 and 2005

Gain on extinguishment of debt, net of write–off of unamortized issuance expenses, was $20.3 million and $31.4 million for the three and nine months ended September 30, 2005, respectively. In June 2005, 1,482,000 shares of our common stock with a fair value of approximately $10.6 million and approximately $15.8 million in cash were exchanged for $38.0 million aggregate principal amount of our outstanding convertible subordinated notes due 2008. In the third quarter of 2005, we completed four additional exchanges wherein we exchanged a total of 3,506,100 shares of our common stock with a fair value of approximately $27.0 million and approximately $41.4 million in cash for $89.9 million aggregate principal amount of our Notes. There was no extinguishment of debt during the nine months ended September 30, 2006.

OTHER INCOME (EXPENSES)

Three months ended September 30, 2006 and 2005

Net other income was $1.8 million and $7.4 million for the three months ended September 30, 2006 and 2005, respectively. Net other income for the three months ended September 30, 2006 primarily consisted of dividend income of $1.0 million. Net other income for the three months ended September 30, 2005 primarily consisted of foreign exchange gains of $7.3 million. The foreign exchange gains were primarily the result of gains for the company's China subsidiaries attributed to the appreciation of the Chinese Renminbi on US dollar denominated short–term debt and payables, offset by a loss attributed to the appreciation of the US dollar on Japanese Yen denominated cash and accounts receivable.

Nine months ended September 30, 2006 and 2005

Net other income was $12.3 million for the nine months ended September 30, 2006 and net other expense was $1.7 million for the nine months ended September 30, 2005. Net other income for the nine months ended September 30, 2006 primarily consisted of gains from foreign exchange of $6.1 million, a $2.5 million gain on sale of assets to Cellon and dividend income of $1.7 million. Net other income for the nine months ended September 30, 2005 primarily consisted of a $6.0 million consumption tax refund in Japan offset by a foreign exchange loss of $7.3 million.

INCOME TAX EXPENSE

Income tax expense is based upon a blended effective tax rate based upon our expectation of the amount of income to be earned in each tax jurisdiction and is accounted under the liability method. Deferred income taxes are recognized for the differences between the tax bases of assets and liabilities and their financial statement amounts based on enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. We will maintain a full valuation allowance on our net deferred tax assets in China, the United States, and other countries until an appropriate level of profitability that generates taxable income is sustained or until we are able to develop tax strategies that would enable us to conclude that it is more likely than not that a portion of our deferred tax assets will be realizable. Any reversal of valuation allowances will favorably impact our results of operations in the period of the reversal.

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax–related uncertainties based on estimates of whether, and the extent to which, additional taxes and interest will be due. These reserves are established when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are likely to be challenged and may not be sustained on review by tax authorities. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest. In the fourth quarter of 2006, we recorded a $29.0 million income tax benefit related to the settlement of a tax audit in China for the 2003 through 2005 tax years for UTStarcom Telecom Co., Ltd. ("HUTS") and Hangzhou UTStarcom Telecom Co., Ltd ("HSTC"), two of our subsidiaries in China and the acceptance of our tax holiday for HSTC.

Our tax returns for the 2003, 2004 and 2005 tax years are currently under audit by the Internal Revenue Service. We are also under audit by China tax authorities on a recurring basis. We provide tax reserves for federal, state and international exposures relating to audit results, tax planning initiatives and compliance responsibilities. The development of these reserves requires judgments about tax issues, potential outcomes and timing, and is a subjective critical estimate. Although the outcome of these tax audits is uncertain, in management's opinion, adequate provisions for income taxes have been made as a result of these reviews. If actual outcomes differ materially from these estimates, they could have a material impact on our results of operations.

Three months ended September 30, 2006 and 2005

Income tax expense was $1.5 million and $125.2 million for the three months ended September 30, 2006 and 2005, respectively. There are two primary reasons why the Company has tax expense while the Company has pretax losses. First, we have not provided any tax benefit on the forecasted current year losses incurred and tax credits generated in the United States and other countries, because management believes that it is more likely than not that the tax benefit associated with these losses will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable. Estimates of the annual effective tax rate at the end of the interim periods are based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision. As of September 30, 2005, we did not believe it was more likely than not that we would generate a sufficient level and proper mix of taxable income within the appropriate period to utilize all the deferred tax assets. As a result of the review undertaken at September 30, 2005, we concluded that it was appropriate to establish a full valuation allowance for the net deferred tax assets which the cumulative losses weigh heavily in the overall assessment. Accordingly, we recorded a $116.6 million non−cash charge at September 30, 2005 in the United States and China.

Nine months ended September 30, 2006 and 2005

Income tax expense was $9.0 million and $134.0 million for the nine months ended September 30, 2006 and 2005, respectively. In the nine months ended September 30, 2005 we recorded a $116.6 million non−cash charge to provide a full valuation allowance on our remaining net deferred tax assets at September 30, 2005 in the United States and China.

EQUITY IN NET LOSS OF AFFILIATED COMPANIES

Three and nine months ended September 30, 2006 and 2005

Equity in net loss of affiliated companies was $0.8 million and $1.8 million for the three and nine months ended September 30, 2005, respectively. The loss in both periods was primarily attributable to the loss recognized from our joint venture investments with Matsushita Communication Industrial Co., Ltd., and Matsushita Electronic Industrial Co., Ltd. There was no equity net loss of affiliated companies during the three and nine months ended September 30, 2006 as business operations have been terminated.

SEGMENT REPORTING

As of September 30, 2006, we managed our business on the basis of four operating segments, namely Network Solutions, PCD, Handsets and Service. The Network Solutions operating unit provides its products and services through two reporting segments; Broadband Infrastructure and Wireless Infrastructure. Each reporting segment and operating unit is responsible for managing its own performance.

We currently evaluate operating performance of and allocate resources to the reporting segments based on segment gross profit. Cost of sales and direct expenses in relation to production are assigned to the reporting segments. The accounting policies used in measuring segment assets and operating performance are the same as those used by corporate and are consistently applied across all segments.

Summarized below are our segment sales revenue and gross profit for the three and nine months ended September 30, 2006 and 2005, respectively.

Network Solutions

Broadband Infrastructure

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
		(As restated)		(As restated)
	(in thousands)		(in thousands)	
Sales	$ 50,754	$ 31,018	$ 152,774	$ 414,148
Gross profit	$ (837)	$ (13,875)	$ 27,138	$ 166,958
Gross profit as a percentage of sales	(2)%	(45)%	18%	40%

Our largest Broadband Infrastructure customer is Softbank in Japan, representing approximately 50% and 35% of total broadband sales during the three months ended September 30, 2006 and 2005, respectively, and 66% and 90% during the nine months ended September 30, 2006 and 2005, respectively. Due to the customer concentration in this segment, revenues fluctuate based upon the magnitude and timing of revenue recognition on certain contracts.

Net sales from the Broadband Infrastructure segment increased $19.7 million for the three months ended September 30, 2006 as compared to the same quarter in 2005. The increase is primarily due to an $8.5 million order cancellation fee included in revenue for the three months ended September 30, 2006, and expected fluctuations resulting from customer concentration.

Gross profit during the three months ended September 30, 2006 improved to negative 2% compared with a negative gross profit of 45% during the three months ended September 30, 2005. The gross profit for the three months ended September 30, 2006 of negative 2% was positively impacted by $8.5 million of order cancellation fees, and negatively impacted by additional warranty reserves of $4.7 million for the NetRing and GEPON equipment sold to Softbank during 2003 and 2004. Our Broadband Infrastructure operating segment reported a negative gross margin of 45% during the three months ended September 30, 2005, primarily due to recognizing $4.9 million of additional warranty expense relating to sales made principally in Japan in prior quarters of three products where quality issues were encountered. We also had a $4.0 million increase in our overall estimated warranty liability for Broadband Infrastructure products in this three month period based on the results of an analysis of warranty costs incurred.

Broadband Infrastructure net sales during the nine months ended September 30, 2005, included one large transaction with Softbank totaling $271.9 million of revenue on certain agreements entered into with Japan Telecom primarily for the iAN8000 product in 2005. Included in Broadband Infrastructure sales for the nine months ended September 30, 2006 are order cancellation fees of $31.2 million and included in cost of sales is a $4.4 million inventory write–down.

Wireless Infrastructure

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005 (As restated)	2006	2005 (As restated)
	(in thousands)		(in thousands)	
Sales	$ 110,299	$ 77,586	$ 331,997	$ 310,708
Gross profit	$ 54,217	$ 16,332	$ 158,835	$ 77,661
Gross profit as a percentage of sales	49%	21%	48%	25%

During the three months ended September 30, 2006, sales of Wireless Infrastructure products increased by 42% compared to the same period in 2005. PAS systems sales increased 26% during the three months ended September 30, 2006 and comprised approximately 85% of our Wireless Infrastructure sales for the three months ended September 30, 2006 compared to 95% during the same period ended September 30, 2005. The increase in PAS systems sales was primarily due to the deferral and subsequent amortization of revenues as noted in our China sales investigation. Certain contracts we signed with customers in prior years included terms requiring us to defer such revenues and then recognize them ratably in subsequent years over the period we are obligated to provide the post contract support (For more information regarding the China sales investigation, see "Restatement of Consolidated Financial Statements" in Item 2 of this Form 10–Q). The shift in timing of the revenue recognition for these contracts offset decreases in sales due to maturity of our PAS system product lines. Sales of products other than PAS systems, including our Moving Media 2000 and Moving Media 6000 products, comprised the remaining 15% of sales during the three months ended September 30, 2006.

During the nine months ended September 30, 2006, Wireless Infrastructure sales increased by 7% compared to the same period in 2005. The increase is primarily due to the deferral and subsequent amortization of revenues as noted in our China sales investigation, and (i) the increase in sales of other products including Moving Media 2000 and Moving Media 6000; and (ii) the deferral and subsequent amortization of certain long–term contracts as noted above offsetting most of the decline of PAS system sales. Worldwide PAS system sales decreased by 5% and comprised approximately 84% of our Wireless Infrastructure sales for the nine months ended September 30, 2006 compared to 95% during the same period ended September 30, 2005. Excluding amortization of long–term contracts, new sales in China have declined continuously since late 2004 as carriers have transitioned from new system installations to system expansions as PAS/iPAS systems reach product maturity.

We anticipate moderate declines in PAS system spending. We plan to aggressively pursue opportunities for our other technology products in multiple markets, though we do not anticipate that these sales will fully offset the decline in PAS sales over the next twelve months.

Gross profit as a percentage of sales increased by 28 percentage points in the three months ended September 30, 2006, as compared to the corresponding quarter in 2005 due to a number of factors including: (i) the margins on PAS infrastructure improved due to a shift in product mix towards higher margin cell sites as well as a reduction in product discounts given; (ii) an improvement in inventory management and product quality resulting in a decrease in excess/slow moving inventory write–downs ; and (iii) a decrease in component material costs.

Gross profit as a percentage of sales increased by 23 percentage points in the nine months ended September 30, 2006, as compared to the corresponding nine months in 2005 due to a number of factors, including: (i) the margins on PAS infrastructure improved due to a shift in product mix towards higher margin cell sites as well as a reduction in product discounts given; (ii) an improvement in inventory management and product quality resulting in a decrease in excess inventory write–downs and scrap as compared with the comparable 2005 period; and (iii) sales of voice and data networks software totaling $14.7 million in 2006 which typically have gross margins of approximately 90%.

PCD

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005 (As restated)	2006	2005 (As restated)
	(in thousands)			
Sales	$ 328,701	$ 363,637	$ 917,943	$ 1,021,452
Gross profit	$ (7,057)	$ 13,199	$ 19,653	$ 42,881
Gross profit as a percentage of sales	(2)%	4%	2%	4%

Revenue for the PCD segment decreased 10% during the three months ended September 30, 2006 as compared to the same quarter in 2005. The decrease in revenue was the result of a 17% decrease in the number of units sold, offset partially by an increase in the overall average selling price. The number of units sold during the three months ended September 30, 2006 of 1.7 million reflected a decrease of approximately 375,000 units from the comparable period in 2005. Partially offsetting the effect of the decrease in units sold was a 10% increase in the average sales price per unit.

Historically, PCD has relied upon a limited number of manufacturers to supply its handset products. During the three and nine months ended September 30, 2006, sales of UTStarcom branded devices increased to approximately 14% and 13%, respectively, from zero in the same periods last year. In addition, three other vendors combined to account for approximately 72% and 77% of handset products sold during the three and nine months ended September 30, 2006, respectively.

Gross profit as a percentage of sales decreased to negative 2% and positive 2% of net sales for the three and nine months ended September 30, 2006, respectively compared with 4% of net sales for the same periods in 2005. The decreased gross profit in 2006 was primarily due to inventory write–down to market for certain slow moving models purchased in Q3 2006 in connection with the Strategic Alliance Agreement entered into with Pantech & Curitel Communications, Inc. on September 25, 2006. Partially offsetting these inventory charges were higher margins on UTStarcom branded devices sold during 2006.

Handsets

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005 (As restated)	2006	2005 (As restated)
	(in thousands)			
Sales	$ 93,163	$ 106,294	$ 299,266	$ 378,256
Gross profit	$ 24,012	$ 13,633	$ 88,521	$ 48,972
Gross profit as a percentage of sales	26%	13%	30%	13%

Handsets sales declined 12% for the three months ended September 30, 2006 compared to the same period in 2005. Nearly all our handset sales are in China, where we have experienced a decline in volume for our PAS handsets, partially offset by an increase in the per–unit average price. The units sold declined to 1.7 million compared to 2.1 million in the comparable period last year. The 20% volume decline was primarily attributed to lower demand for our PAS handsets resulting from slower subscriber growth as service providers reduced marketing efforts for PAS handsets in anticipation of next generation technology networks.

The decline in revenue resulting from the decrease in units sold was partially offset by an increase in the average selling price per unit. The average selling price per unit improved due to a shift in product mix to sales of higher–end models, including our new PAS/GSM dual mode model. This shift in product mix more than offset declining prices of other models due to competitive pricing pressures in the PAS market, which we have experienced in the China telecommunications market since the latter part of 2003. We expect to see cumulative PAS subscriber growth at lower rates in future periods.

Handset sales declined 21% for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005. As noted above, the decrease in net sales was primarily attributable to declining volume in the China telecommunications market. Unit sales declined to 5.8 million for the nine months ended September 30, 2006 compared to 8.1 million units in the prior year. The average selling price per unit remained relatively stable due to the offset of competitive pricing pressures in the PAS market with a shift in product mix to sales of higher end models including our new dual mode model.

Gross profit as a percentage of sales for our handsets segment increased by 13% in the three months ended September 30, 2006, as compared to the corresponding quarter in 2005. A significant portion of the improvement in the gross profit percentage relates to shifting most of our products to the use of chip–sets with greater functionality in PAS handsets that reduce the overall component costs of each unit. Additionally, we have had a shift in product mix towards higher margin products such as our PAS/GSM dual mode and ultra–thin high–end PAS handsets. Additional factors leading to the improvement in gross profit is a reduction in variances and overhead.

Gross profit as a percentage of sales for our handsets segment increased by 17% in the nine months ended September 30, 2006, as compared to the corresponding nine months in 2005. A portion of the improvement in the gross profit percentage relates to shifting most of our products to the use of chip–sets with greater functionality in PAS handsets that reduce the overall component costs of each unit. Additionally, we have had a shift in product mix towards higher margin products such as our PAS/GSM dual mode and ultra–thin high–end PAS handsets. Additional factors leading to the improvement in gross profit are a reduction in variances and warranty costs.

We believe our Handset segment is positioned to meet future market demand as we were awarded a license to sell both GSM and CDMA handsets in China in July 2005. Additionally, we are focusing on expanding our handset product offering outside of China. However, we do not expect gross profit as a percentage of sales to continue at this level over the remainder of the year as the decline of the price per unit will likely exceed our ability to continue to reduce per–unit costs.

Service

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005 (As restated)	2006	2005 (As restated)
	(in thousands)			
Sales	$ 17,982	$ 18,900	$ 52,426	$ 65,454
Gross profit	$ 4,466	$ 8,598	$ 13,395	$ 36,709
Gross profit as a percentage of sales	25%	45%	26%	56%

Our Service segment's revenue decreased by $0.9 million for the three months ended September 30, 2006 as compared to the corresponding quarter last year. Included in service revenue during the three months ended September 30, 2006 is revenue of $4.1 million related to support and service performed for Softbank affiliates compared to $2.1 million during the same period in 2005.

During the nine months ended September 30, 2006, we focused on the revenue opportunities with respect to support in China. Approximately 477 employees previously providing sales and support services were shifted towards generating revenue from support arrangements, resulting in additional cost of goods sold for the three and nine months ended September 30, 2006 of $4.1 million and $11.0 million, respectively, with a related decrease in the gross profit as a percentages of sales and a corresponding decrease to operating expenses. Additionally, revenues of $2.1 million and $7.5 million from Wireless Infrastructure and $0.1 million and $0.5 million from Broadband Infrastructure segment sales in China were allocated to the Service segment during the three and nine months ended September 30, 2006, respectively. The allocation was made on certain completed contracts for which the service element was not separately priced.

Our Service segment revenue declined by $13.0 million, or 20%, for the nine months ended September 30, 2006 as compared to the corresponding period last year. The Service segments revenue for the nine months ended September 30, 2006 included $10.7 million of revenue associated with services performed for Softbank and affiliates compared to $21.1 million during the same period in 2005.

LIQUIDITY AND CAPITAL RESOURCES

Operating Activities

2006

Net cash provided by operating activities for the nine months ended September 30, 2006 was $18.1 million. Operating cash was affected by changes in accounts receivable and customer advances, and offset by the net loss as well as changes in inventories and other current liabilities.

The $105.5 million decrease in accounts receivable was attributable to a decline in sales preceding the end of the September 30, 2006 quarter as compared to sales preceding December 31, 2005. Days sales outstanding, when calculated using the preceding quarterly sales, decreased to 69 days at September 30, 2006 as compared to 95 days at September 30, 2005 as a result of improved cash collections.

Customer advances increased by $61.8 million for the nine months ended September 30, 2006, primarily due to a longer construction and testing period for the IPAS market. Customer advances represent cash deposits we have received from our customers for orders that have not yet received final acceptance. Upon subsequent receipt of final acceptances and revenue recognition, customer advances are reduced and revenue and cost of sales is recorded.

The decrease in other current liabilities is primarily the result of a decrease in other taxes payable of approximately $13.5 million, a decrease in warranty liabilities of $11.8 million, a decrease in accrued contract costs, which relate to purchase of goods and services for which invoices have not been received of approximately $9.1 million and a decrease of approximately $24.7 million in other liabilities.

Non−cash charges for the nine months ended September 30, 2006 included $51.5 million of depreciation and amortization, and a $13.1 million of stock−based compensation expense. In addition, a $12.3 million gain was recognized from the sale of semiconductor design assets to Marvell Technology Group, Ltd. during the nine months ended September 30, 2006.

2005

Net cash provided by operating activities for the nine months ended September 30, 2005, was $83.6 million. Operating cash was primarily affected by changes in accounts receivable, inventory, and current and non−current assets, offset by changes in customer advances, income tax payable and accounts payable.

The $202.7 million reduction in accounts receivable was primarily attributable to the stronger collections in the third quarter of 2005, and offset by the incremental sales and related receivables from PCD. Days sales outstanding was 140 days, excluding PCD, at September 30, 2005 as compared to 83 days at September 30, 2004. Days sales outstanding was 95 days including PCD at September 30, 2005. The longer days sales outstanding is a direct result of longer collection cycles in China due to the slow−down in the telecommunication industry which has necessitated a corresponding increase in the provision for doubtful accounts.

The decreases in inventory balance of $116.0 million and other assets of $85.0 million have contributed to our increase in operating cash.

Customer advances decreased by $164.8 million and income tax payable decreased by $118.6 million for the nine months ended September 30, 2005. In addition, accounts payable decreased by $120.5 million. All of these factors contributed to a decrease in operating cash. Customer advances represent cash deposits we have received from our customers for orders that have not yet received final acceptance. Upon subsequent receipt of final acceptances and revenue recognition, customer advances are reduced and revenue and cost of sales are recorded.

The reduction of customer advances in the nine months ended September 30, 2005 was primarily due to the completion of the revenue earning process for most of the agreements with Japan Telecom, Inc. ("JT"), an affiliate of Softbank Corp., as well as the decline in sales and the corresponding cash advances for product sold in China. All cash received from JT in advance of revenue recognition and in advance of spending for promotional activities was reflected as a customer advance in prior periods. Revenue for certain of these agreements has been recognized in the nine months ended

September 30, 2005. For additional information, refer to Note 18, "Related Party Transactions," to our condensed consolidated financial statements.

Non–cash charges for the nine months ended September 30, 2005 included a change of $192.4 million in deferred income taxes as a result of recording the valuation allowance, a $218.1 million asset impairment charge, $78.5 million of depreciation and amortization, a $38.1 million provision for doubtful accounts and a $14.6 million provision for deferred costs, excluding $5.5 million write–off of inventory associated with the Restructuring. In the nine months ended September 30, 2005, we recorded a $31.4 million non–cash gain on extinguishment of debt which offsets activities that increase operating cash.

Investing Activities

2006

Net cash provided by investing activities for the nine months ended September 30, 2006 totaled $32.6 million. Cash inflows from investing activities included $20.0 million received from the sale of the semiconductor design business division to Marvell Technology Group, Ltd., $42.1 million of proceeds of the sale of short–term investments and $26.5 million in changes to restricted cash. Cash outflows for investing activities, including $17.2 million of additions to property, plant and equipment, and $40.2 million of purchases of short–term investments.

2005

Net cash provided by investing activities for the nine months ended September 30, 2005, totaling $32.5 million was primarily due to $121.2 million of net proceeds from the purchase and sale of short–term investments. The cash outflow was principally attributable to $24.3 million related to our acquisitions of Giga Telecom, Inc. in the first quarter of 2005, and Pedestal Networks in the second quarter 2005, and $60.9 million in purchases of property, plant and equipment.

Financing Activities

2006

Net cash used in financing activities was $96.4 million, primarily consisting of a net repayment of short–term borrowings in excess of new borrowings of $96.0 million.

2005

Net cash used in financing activities was $182.8 million for the nine months ended September 30, 2005. This was primarily due to the net repayment of borrowing of $131.8 million and $57.1 million cash payment in conjunction with an early debt extinguishment.

Liquidity

We reported net losses in each quarter in the period beginning April 1, 2005 and continuing through September 30, 2006, which have resulted in an accumulated deficit of $452.2 million and total stockholders' equity being reduced to $789.3 million at September 30, 2006. Additionally, at September 30, 2006, we had short–term debt in China under lines of credit to our China subsidiaries of $105.0 million maturing in 2007 and long–term debt outside of China in the form of 7/8% convertible subordinated notes with a principal balance of $274.6 million that matures in March 2008.

Our working capital was $815.6 million and $811.8 million at September 30, 2006 and 2005, respectively, and included cash on hand of $604.4 million and $496.1 million and short term investments of $12.3 million in and $15.1 million, respectively in 2006 and 2005. Planned capital expenditures include an increase in the level of our capital expenditures in China in 2007 by approximately $40 million to support wire line telephone carriers in China who utilize our products and services to provide television service to their customers using the IPTV protocol.

Credit facilities in China at September 30, 2006 totaled $789.5 million, with $498.5 million of this amount available for working capital purposes, of which we had drawn $105.0 million in outstanding borrowings, with interest rates up to 5.02%, and $291.0 million was available for use in support of letters of credit and corporate guarantees. These facilities expire primarily in November and December of 2007. We believe that based upon our recent financial performance and financial position our lenders may reduce the total available credit when it negotiates renewals of these lines. Furthermore,

each borrowing under the credit facilities is subject to the bank's current favorable opinion of the credit worthiness of the Company's China subsidiaries, as well as the bank having funds available for lending and other Chinese banking regulations. However, we believe the amounts of credit our lenders may make available and the borrowings made under the renewed lines of credit will be sufficient to meet planned uses of these credit facilities.

As of September 30, 2007 our outstanding borrowings under the credit facilities in China total $140.1 million, with interest rates of up to 6.67%, with varying maturity dates through September 2008. The Company's practice in China is to draw new loans under the credit facilities prior to either the maturity of our borrowings or expiration of our facilities to ensure we maintain adequate liquidity to re-pay the existing borrowings at maturity, or to effectively lengthen the credit facility period to the latest maturity date of the underlying borrowings.

Of our total cash and short-term investments at September 30, 2006 of $616.7 million, a total of $455.4 million is held in China. To meet liquidity needs outside of China, our subsidiaries in China have the ability to transfer cash to the Company in the United States under China's current exchange control regulations. The amount of cash available for transfer from the China subsidiaries is limited both by liquidity needs of the subsidiaries in China and by Chinese government requirements that the China subsidiaries retain adequate capital levels in China to protect creditors and to have funds available for mandated employee benefits. We believed the China subsidiaries could freely transfer at least $200 million as of December 31, 2006, and during the nine months ended September 30, 2007 our China subsidiaries have made such transfers of funds out of China to the Company totaling $150 million.

Although management believes we now have a sufficient amount of cash resources to finance our anticipated working capital and capital expenditure requirements for the next 12 months, we do not have enough cash outside of China to repay the convertible notes due on March 1, 2008. Management's liquidity plans include a partial or complete refinancing of the convertible notes, renewal of the lines of credit in China, transfers of more cash from its subsidiaries in China to the extent necessary, and, if needed, liquidation of certain investments and/or seeking new financing arrangements. Our ability to maintain sufficient liquidity is also dependent on achieving projected sales and operating margin forecasts.

The convertible notes were issued in March 2003 when we completed an offering of $402.5 million of 7/8% convertible subordinated notes due March 1, 2008 to qualified institutional buyers. The notes are convertible into our common stock at a conversion price of $23.79 per share and are subordinated to all of our present and future senior debt. Concurrent with the issuance of the convertible notes, we entered into a convertible bond hedge and a call option transaction with respect to our common stock. Both the bond hedge and call option transactions may be settled at our option either in cash or net shares and expire on March 1, 2008. During 2005, we completed exchanges of approximately 5.0 million shares of our common stock and approximately $57.1 million in cash for $127.9 million aggregate principal amount of outstanding notes. As a result of the early extinguishment, we also amended the convertible bond hedge and call option transactions to reflect the change in principal amount of the underlying notes.

If an event of default were to occur and be continuing, the Trustee or the holders of at least 25% in aggregate principal amount of the notes then outstanding could declare all unpaid principal and accrued interest on the Notes then outstanding to be immediately due and payable. Therefore as a result of our inability to timely file our Quarterly Report on Form 10-Q for the period ended September 30, 2006, because the independent review by the Governance Committee of the Company's historic stock option accounting was not completed, after receiving a purported notice of default from the trustee asserting that the delay in filing and a failure to comply with certain covenants had caused a default under the indenture, we solicited and received the requisite consents from the holders of the notes to a waiver of any defaults which may have occurred to and including January 9, 2007, caused by a delay in filing SEC Reports and entered into a First Supplemental Indenture with the trustee, dated January 9, 2007, which provided that any failure by us to comply with certain provisions of the original agreement will not result in a default or an event of default through May 31, 2007. After receiving a notice of default from the trustee asserting that our inability to timely file SEC Reports and comply with certain covenants as of May 31, 2007 had caused a default under the indenture, we solicited and received the requisite consents from the holders of the notes to a waiver of any defaults which may have occurred to and including July 26, 2007 and entered into a Second Supplemental Indenture with the trustee, after receiving consent from holders of more than 50% of the outstanding aggregate principal amount of the convertible subordinated notes in connection with our consent solicitation announced July 19, 2007. The Second Supplemental Indenture provides that (i) during the period from and including July 26, 2007 to and including October 15, 2007 ("Covenant Reversion Date"), any failure by us to comply with the covenants contained in the original indenture agreement related to the required filing of reports with the SEC, and the furnishing of copies of the SEC reports and certain compliance certificates to the Trustee, will not constitute a default, and that (ii) if, but for the Second Supplemental Indenture, a default would be deemed to have occurred as a result of a failure to comply with such covenants and such default remains uncured and is continuing as of the Covenant Reversion Date, such default will be deemed to have occurred on the Covenant Reversion Date.

Under the Second Supplemental Indenture, the convertible subordinated notes accrue an additional 6.75% per annum in special interest from and after January 9, 2007 to and including July 25, 2007, and an additional 10% per annum in special interest from and after July 26, 2007 to the date the notes are paid, prepaid, redeemed, converted or otherwise cease to be outstanding. The special interest rate accruing on the notes after July 26, 2007 represents an increase of 3.25% per annum over the previous special interest rate of 6.75% per annum provided by the First Supplemental Indenture. As a result of the Second Supplemental Indenture, the convertible subordinated notes now bear a stated interest rate of 10.875%. Accordingly, we will have $22.0 million of additional annual interest expense in 2007 while the convertible subordinated notes are outstanding. Payments of special interest will be made in addition to, and at the same time and in the same manner as, regularly scheduled payments of interest to holders entitled to such regularly scheduled payments of interest.

If additional sources of liquidity were needed, the Company would consider new debt or equity offerings or obtaining cash from asset sales, but there is no assurance that such transactions could be consummated on acceptable terms or at all. Failure to raise sufficient capital when needed could have a material adverse effect on the business, results of operations and financial position of the Company.

Our China sales are generally denominated in local currency, and we accept commercial notes receivable with maturity dates of between three and six months from our customers in China in the normal course of business. Notes receivable available for sale was $8.5 million and $2.1 million at September 30, 2006 and December 31, 2005, respectively. We may discount these notes with banking institutions in China. Any notes that have been sold are not included in our consolidated balance sheets as the criteria for sale treatment established by Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities" ("SFAS 140") have been met.

Due to the limitations on converting Renminbi, we are limited in our ability to engage in foreign currency hedging activities in China. We cannot guarantee that fluctuations in foreign currency exchange rates in the future will not have a material adverse effect on revenues from international sales and, correspondingly, on our business, financial condition, results of operations and cash flows. We have contracts negotiated in Japanese Yen and we maintain bank accounts in Japanese Yen for purchasing portions of our inventories and supplies. The balance of these Japanese Yen accounts at December 31, 2006 was approximately $13.1 million.

On August 1, 2005, we entered into a 364–day $100.0 million committed receivables purchase facility with a financial institution. In March 2007, the agreement was amended and restated to reflect that the purchase of trade receivables shall be at the sole discretion of the financial institution. The agreement was also extended to the earlier of (i) March 28, 2008 or (ii) upon 90 days written notice by the financial institution. Pursuant to the terms of the receivable purchase facility, we may sell certain receivables arising from the sale of telecommunications equipment to this financial institution. No receivables had been sold pursuant to this arrangement.

We have not guaranteed any debt that is not included in the consolidated balance sheet.

Income Taxes

Certain subsidiaries and joint ventures located in China enjoy tax benefits in China which are generally available to foreign investment enterprises, including full exemption from national enterprise income tax for two years starting from the first profit–making year and/or a 50% reduction in national income tax rate for the following three years. In addition, local enterprise income tax is often waived or reduced during this tax holiday/incentive period. Under current regulations in China, foreign investment enterprises that have been accredited as technologically advanced enterprises are entitled to additional tax incentives. These tax incentives vary in different locales and could include preferential national enterprise income tax treatment at 50% of the usual rates for different periods of time. The tax holidays discussed above are applicable or potentially applicable to CUTS, HUTS, Hangzhou UTStarcom Telecom Co., Ltd. ("HSTC") and UTStarcom China Co., Ltd. ("UTSC"), our active subsidiaries in China, as those entities may qualify as accredited technologically advanced enterprises.

On March 16, 2007, China's top legislature, the National People's Congress, passed the China Corporate Income Tax Law ("CIT Law"). CIT Law will be effective on January 1, 2008. Under the CIT Law, China's dual tax system for domestic enterprises and foreign investment enterprises ("FIEs") would be effectively replaced by a unified system. The new law establishes a tax rate of 25% for most enterprises and a reduced tax rate of 15% for certain qualified high technology enterprises.

Prior to this change in tax law, certain subsidiaries and joint ventures located in China enjoyed tax benefits in China which are generally available to FIEs. The tax holidays/incentives for FIEs were applicable or potentially applicable to

CUTS, HUTS, HSTC and UTSC, our active subsidiaries in China, as those entities may qualify as accredited technologically advanced enterprises.

CIT Law targets certain industries for the reduced 15% tax rate for certain qualified high technology enterprises. For FIEs established before the promulgation of the new law who currently enjoy lower tax rates, any increase in their tax rates would be gradually phased in over five years. Significant regulations regarding the interpretation and implementation of the new tax law are still pending. There is potential risk that our subsidiaries may not qualify for the reduced 15% tax rate. Therefore, the new law may have an adverse impact on our future tax expense in China.

Moreover, the Chinese central government may review and audit tax benefits granted by local or provincial authorities and could determine to disallow such benefits. Certain of our subsidiaries and joint ventures located in China enjoy tax benefits in China that are generally available to foreign investment enterprises. If these tax benefits are reduced, disallowed or repealed due to changes in tax laws or determination by the Chinese government, our business could suffer.

Off Balance Sheet Arrangements

On August 1, 2005, we entered into a committed receivables purchase facility with Citibank, N.A., which provides for the sale of up to $100.0 million of trade accounts receivable of our PCD segment. Sales of the accounts receivables to Citibank, N.A. under this program will result in a reduction of total accounts receivable in our consolidated balance sheet. The remaining accounts receivables not sold to Citibank, N.A. will be carried at their net realizable value, including an allowance for doubtful accounts. We have not sold any receivables pursuant to this facility during 2005 or the first nine months of 2006. We believe that available funding under our accounts receivable financing program provides us increased flexibility to manage working capital requirements, and that there are sufficient trade accounts receivable to support the U.S. financing programs. Under the program, we will continue to service the accounts receivable.

At September 30, 2006, we have no other off balance sheet arrangements.

Contractual Obligations and Other Commitments

Our obligations under contractual obligations and commercial commitments are as follows:

	Payments due by period				
	Total	Less than 1 year	1–3 years	3–5 years	over 5 years
			(in thousands)		
Contractual Obligations					
Bank loans	$ 105,010	$ 105,010	$ —	$ —	$ —
Convertible subordinated notes	$ 274,600	$ —	$ 274,600	$ —	$ —
Interest payable on debt	$ 37,850	$ 23,940	$ 13,910	$ —	$ —
Lease obligations	$ 41,991	$ 16,467	$ 19,949	$ 3,609	$ 1,966
Other Commercial Commitments					
Letters of credit	$ 53,281	$ 49,640	$ 3,641	$ —	$ —
Purchase commitments	$ 730,216	$ 663,560	$ 66,656	$ —	$ —

Bank Loans

At September 30, 2006, we had loans with various banks totaling $105.0 million and each with interest rate to 5.02% per annum. These bank loans mature within twelve months and are included in short–term debt. There are no significant covenants associated with these loans.

Convertible Subordinated Notes

Our convertible subordinated notes, due March 1, 2008, are convertible into our common stock at a conversion price of $23.79 per share and are subordinated to all our present and future senior debt. The principal is due only at maturity of the notes.

Effective January 9, 2007, the Company and the holders of the remaining $274.6 million of convertible subordinated notes entered into a First Supplemental Indenture, providing that any failure by us to comply with certain provisions of the original agreement will not result in a default or an event of default through May 31, 2007. The convertible subordinated notes

accrue an additional 6.75% per annum in special interest from and after January 9, 2007 to the March 1, 2008 maturity date of the notes, unless the notes are earlier repurchased or converted. On July 26, 2007, we entered into a Second Supplemental Indenture providing that the convertible subordinated notes will accrue an additional 10% per annum in special interest from and after July 26, 2007 to the March 31, 2008 maturity date of the notes unless the notes are earlier repurchased or converted. The special interest rate represents an increase of 3.25% per annum over the previous special interest rate of 6.75% per annum in the First Supplemental Indenture. As a result of the Second Supplemental Indenture, the convertible subordinated notes now bear a stated interest rate of 10.875%. Interest is payable semiannually on March 1 and September 1, and payments of the special interest are made in addition to and at the same time and in the same manner as regularly scheduled payments of interest to holders entitled to such regularly scheduled payments of interest. For more information regarding the notice of default on May 31, 2007 and the Company's Second Supplemental Indenture see the "Liquidity" section of this Quarterly Report.

Operating Leases

We lease certain facilities under non–cancelable operating leases that expire at various dates through 2013.

Letters of credit

We issue standby letters of credit primarily to support international sales activities outside of China. When we submit a bid for a sale, often the potential customer will require that we issue a bid bond or a standby letter of credit to demonstrate our commitment through the bid process. In addition, we may be required to issue standby letters of credit as guarantees for advance customer payments upon contract signing or performance guarantees. The standby letters of credit usually expire six to twelve months from date of issuance without being drawn by the beneficiary thereof.

Purchase commitments

We are obligated to purchase raw materials and work–in–process inventory under various orders from various suppliers, all of which should be fulfilled without adverse consequences material to our operations or financial condition. As of September 30, 2006, total purchase commitments, including cancelable and non–cancelable purchase orders, approximated $730 million. Additionally, we have agreed to purchase from Marvell certain chip–sets that will be included in our PAS handsets through 2011.

Investment commitments

As of September 30, 2006, we had invested a total of $2.6 million in Global Asia Partners L.P. that is recorded as a long–term investment. The fund size is anticipated to be $10.0 million and the fund was formed to make private equity investments in private or pre–IPO technology and telecommunications companies in Asia. We had a commitment to invest up to a maximum of $5.0 million. As the result of a reorganization of capital contributions by the partners, reached in April 2005, our capital contribution of $0.5 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re–invest up to $2.5 million that otherwise would have been available to us as future distributions. There were no cash distributions during the three or nine months ended September 30, 2006 or 2005.

Intellectual property

Certain sales contracts include provisions under which customers would be indemnified by us in the event of, among other things, a third–party claim against the customer for intellectual property rights infringement related to our products. There are no limitations on the maximum potential future payments under these guarantees. We have not accrued any amounts in relation to these provisions as no such claims have been made and we believe we have valid enforceable rights to the intellectual property embedded in our products.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 24, "Recent Accounting Pronouncements", of Notes to Condensed Consolidated Financial Statement in Item 1 of this Quarterly Report for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

ITEM 3—QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We are exposed to the impact of interest rate changes, changes in foreign currency exchange rates and changes in the stock market.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The fair value of our investment portfolio would not be significantly affected by either a 10% increase or decrease in interest rates due mainly to the short−term nature of most of our investment portfolio. However, our interest income can be sensitive to changes in the general level of U.S. interest rates since the majority of our funds are invested in instruments with maturities less than one year. Our policy is to ensure the safety of invested funds by generally attempting to limit market risk. Funds in excess of current operating requirements are mostly invested in government−backed notes, commercial paper, floating rate corporate bonds, fixed income corporate bonds and tax−exempt instruments. In accordance with our investment policy, all short−term investments are invested in "investment grade" rated securities with minimum A or better ratings. Currently, most of our short−term investments have AA or better ratings.

The table below represents carrying amounts and related weighted−average interest rates of our investment portfolio at September 30, 2006:

		(in thousands, except interest rates)
Cash and cash equivalents	$	604,410
Average interest rate		2.04%
Restricted cash	$	23,835
Average interest rate		4.83%
Short−term investments	$	12,330
Average interest rate		1.74%
Restricted cash long−term	$	3,640
Average interest rate		4.93%
Total cash, cash equivalents and investment securities	$	644,215
Average interest rate		2.16%

Equity Investment Risk:

Our investment portfolio includes equity investments in publicly traded companies, the values of which are subject to market price volatility. Economic events could adversely affect the public equities market and general economic conditions may worsen. Should the fair value of our publicly traded equity investments decline below their cost basis in a manner deemed to be other−than−temporary, our earnings may be adversely affected. We have also invested in several privately held companies as well as investment funds which invest primarily in privately held companies, many of which can still be considered in the start−up or development stages. These investments are inherently risky, as the market for the technologies or products they have under development are typically in the early stages and may never materialize.

Debt Investment Risk:

Our debt investment portfolio consists of a $2.4 million note receivable from BB Modem, an affiliate of SOFTBANK CORP., pursuant to a Mezzanine Loan Agreement we entered into with BB Modem on July 17, 2003. Our loan is subordinated to certain senior lenders of BB Modem, and repayments are payable to us over a 42−month period, with a substantial portion of the principal amount of the loan repaid during the last 16 months of this period. Our recourse for nonpayment of the loan is limited to the assets of BB Modem, the account into which subscriber payments are made and its rights under the securitization transaction documents. The value of BB Modem's modems that serve as collateral for the loan may decrease over time and may not be sufficient upon sale to pay the outstanding amounts on the loan. The note receivable was paid in full in January 2007.

Foreign Exchange Rate Risk:

We are exposed to foreign currency exchange rate risk because most of our sales in China are denominated in Renminbi and portions of our accounts receivable and payable are denominated in Japanese Yen. Due to the limitations on

converting Renminbi, we are limited in our ability to engage in foreign currency hedging activities in China. Although the impact of currency fluctuations of Renminbi to date has been slight, fluctuations in currency exchange rates in the future may have a material adverse effect on our results of operations. The balance of cash and short–term investment balance held in China was $455.4 million at September 30, 2006. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The move revalued the Renminbi by 2.1% against the U.S. dollar. Additionally, during 2005 and the first nine months of 2006 we made significant sales in both Japanese Yen and in Euros. We maintain Japanese Yen bank accounts for purchasing portions of our inventories and supplies.

Our revenues, earnings and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. We may hedge currency exposures associated with certain assets and liabilities denominated in nonfunctional currencies and certain anticipated nonfunctional currency transactions using forward foreign currency exchange rate contracts. We have not hedged any such transactions, and due to the limitations on converting Renminbi, we are limited in our ability to engage in currency hedging activities in China. As a global concern, we face exposure to adverse movements in foreign currency exchange rates.

We have performed a sensitivity analysis as of September 30, 2006, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% positive or adverse movement in the levels of foreign currency exchange rates relative to the U.S. Dollar, with all other variables held constant. The analysis covers all of our foreign currency contracts offset by the underlying exposures. The foreign currency exchange rates used were based on market rates in effect at September 30, 2006. The sensitivity analysis indicated that a hypothetical 10% movement in foreign currency exchange rates would result in a gain or loss in the fair values of our foreign exchange financial instruments of $4.3 million at September 30, 2006.

ITEM 4—CONTROLS AND PROCEDURES

Governance Committee Review of Historical Stock Option Accounting

In November 2006, UTStarcom, Inc. ("UTStarcom" or the "Company") announced it was conducting a voluntary review of historical stock option practices under the leadership of the Nominating and Corporate Governance Committee of the Company's Board of Directors ("Governance Committee") following a preliminary review by management which identified potential deficiencies and discrepancies in the documentation of stock option grants. The review considered all equity grant awards made in the period from February 29, 2000, shortly before the initial public offering of the Company's Common Stock, through December 31, 2006 ("Review Period") for compliance with the various stock–based compensation accounting standards applicable during the Review Period. Refer to Note 2, "Restatement of Financial Statements" of Notes to Condensed Consolidated Financial Statements in Item 1 of this Quarterly Report on Form 10–Q ("Form 10–Q") for the effect of the restatement adjustments on stock–based compensation expense, additional paid–in capital accounts, related income tax accounts, retained earnings and related financial disclosures for each of the years ended December 31 in the period 1998 through 2005. Further information concerning the Governance Committee's review and the resulting restatements of the Company's historical financial statements can be found in the Explanatory Note preceding Item 1, and in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10–Q, which should be read for a more complete description of this matter.

Based on its findings, the Governance Committee made various recommendations to the Board of Directors. At the Board's direction, management has implemented and will continue to implement remedial actions, including changes to its policies and procedures and enhancements to controls, over its equity–based compensation program. Management has also considered and taken into account the impact of the findings of this review in its "Evaluation of Disclosure Controls and Procedures," as presented below.

Audit Committee Investigation of Historical Sales in China

In July 2007, the Company announced that the Audit Committee of its Board of Directors ("Audit Committee"), with the assistance of independent counsel and forensic accountants, was conducting an independent investigation of allegations of improprieties in certain sales offices in China. The investigation considered sales contracts in each of the seven years in the period ended December 31, 2006. The Investigating Team found instances where the customer contracts that evidenced the arrangement contained obligations for the Company to deliver software upgrades when and if made available for the equipment sold for no additional consideration and for an unspecified period that could extend over the term of the contract. This additional contract obligation is an element of "post contract support". In these cases, the Investigating Team found that contract documentation for the same transaction submitted by the sales office to the Company's China headquarters for accounting purposes and utilized by the Company in determining the amount of revenue recognized did not include evidence of such post contract support obligations.

Refer to Note 2, "Restatement of Financial Statements" of Notes to Condensed Consolidated Financial Statements in Item 1 of this Quarterly Report on Form 10–Q ("Form 10–Q") for the effect of the restatement adjustments on revenue and deferred revenue accounts, cost of sales and deferred cost accounts, related income tax accounts, retained earnings, and related financial disclosures in the Company's consolidated financial statements for the years ended December 31, 2004 and 2005, each of the quarters in the year ended December 31, 2005, and for the first two quarters of the year ended December 31, 2006. Further information concerning the Audit Committee's investigation and the resulting restatements of the Company's historical financial statements can be found in the Explanatory Note preceding Item 1, and in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations included in this Form 10–Q, which should be read for a more complete description of this matter.

Based on the findings, the Audit Committee has made various recommendations to the Board of Directors. At the Board's direction, management has implemented and will continue to implement remedial actions, including changes to its policies and procedures and enhancements to controls, over sales in China. Management has also considered and taken into account the impact of the findings of this investigation in "Management's Annual Report on Internal Control over Financial Reporting," as presented below.

Evaluation of Disclosure Controls and Procedures

UTStarcom maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports the Company files or submits under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's ("SEC's") rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as appropriate, to allow timely decisions regarding required financial disclosure.

In connection with the preparation of this Form 10–Q, the Company carried out an evaluation under the supervision and with the participation of the Company's management, including the CEO and CFO, as of September 30, 2006 of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined in Rules 13a–15(e) and 15d–15(e) under the Exchange Act. Based upon this evaluation, the CEO and CFO concluded that as of September 30, 2006 the Company's disclosure controls and procedures were not effective because of the material weaknesses described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the Company's Annual Report on Form 10–K for the fiscal year ended December 31, 2005, as amended (the "2005 Form 10–K"), which are still in the process of remediation as well as the additional material weaknesses identified below as of September 30, 2006. Investors are directed to Item 9A of the 2005 Form 10–K for the description of previously identified weaknesses.

1. *The Company did not maintain effective controls over its accounting for and disclosure of stock–based compensation expense.* Specifically, the Company did not maintain effective controls, including monitoring, to ensure the completeness, existence, valuation and presentation of stock–based compensation transactions related to the granting, pricing and accounting for certain of its stock–based compensation awards and the related financial reporting for these awards in accordance with GAAP. This control deficiency resulted in the misstatement of the stock–based compensation expense, additional paid–in capital accounts, related income tax accounts, retained earnings and related financial disclosures, and resulted in the restatement of the Company's consolidated financial statements for the years ended December 31, 2004 and 2005, each of the quarters in the year ended December 31, 2005, and the first two quarters of the year ended December 31, 2006.
2. *The Company failed to prevent or detect instances of override related to controls in China over customer agreements.* Specifically, this control deficiency permitted the override of established controls in China's western sales region, by allowing for the existence of undisclosed agreements with customers, which obligated the Company to provide products or perform certain services without the receipt of additional consideration. The existence of these agreements was not communicated to either the Company's financial reporting function or its independent registered public accounting firm. This control deficiency resulted in adjustments to restate revenue and deferred revenue accounts, cost of sales and deferred cost accounts, related income tax accounts, retained earnings, and related financial disclosures in the Company's consolidated financial statements for the years ended December 31, 2004 and 2005, each of the quarters in the year ended December 31, 2005, and for the first two quarters of the year ended December 31, 2006.
3. *The Company did not maintain effective controls at its U.S. headquarters over its accounting for warranty reserves and associated cost of sales.* Specifically, the Company's controls failed to adequately identify, document and analyze required supporting information to ensure the completeness, accuracy, valuation and adequacy of its warranty reserves and to ensure all related costs were recorded in the appropriate period. These processes were not always performed correctly or timely, there was

inadequate management review, and calculation and/or posting errors occurred. This control deficiency resulted in adjustments, including review adjustments, to the consolidated financial statements for the quarter ended September 30, 2006 to correct warranty reserves, which are included in other current liabilities, and the associated cost of sales.

A "material weakness" is a control deficiency in internal control over financial reporting, or a combination of deficiencies in internal control over financial reporting, that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. To address these material weaknesses in internal control over financial reporting noted above, the Company performed additional analyses and other procedures (as further described below under "Management's Further Remediation Initiatives and Interim Measures") to ensure that the Company's consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States ("GAAP"). Accordingly, the Company's management believes that the consolidated financial statements included in this Form 10–Q fairly present in all material respects the Company's financial condition, results of operations and cash flows for the periods presented and that this Form 10–Q does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report.

Management's Further Remediation Initiatives and Interim Measures

The Company plans to make necessary changes and improvements to the overall design of its control environment to address the material weaknesses in internal control over financial reporting described above, including changes to the overall design of its control environment and the roles and responsibilities of each functional group within the organization and the reporting structure, as well as developing policies and procedures to improve overall internal control over financial reporting. In particular, the Company has implemented during 2006, and plans to continue to implement during 2007, the specific measures described below. In addition, in connection with the September 30, 2006 quarter–end reporting process, the Company has undertaken additional measures described under the subheadings "—Interim Measures" below to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements included in this Form 10–Q and to ensure that material information relating to the Company and its consolidated subsidiaries was made known to management in connection with the preparation of this Form 10–Q.

Material weakness 1 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10–K

Remediation Initiatives. The Company's failure to have a sufficient complement of personnel with a level of accounting knowledge, experience and training in the application of GAAP commensurate with the Company's financial reporting requirements contributed to the Company's failure to maintain effective controls over the financial reporting process. To remediate material weakness 1 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10–K, the Company has implemented the measures described below, and will continue to evaluate and may in the future implement additional measures.

1. General Plan for Hiring and Training of Personnel—The Company's planned remediation measures are intended to generally address this material weakness by ensuring that the Company will have sufficient personnel with knowledge, experience and training in the application of GAAP commensurate with the Company's financial reporting requirements. The CFO, with assistance from his senior financial staff and outside consultants, has reviewed and will continue to review and adapt the overall design of the Company's financial reporting organizational structure, including the roles and responsibilities of each functional group within the Company, to ensure that the Company has a sufficient compliment of personnel with knowledge, experience and training in the application of GAAP commensurate with the Company's financial reporting requirements. During 2006 and continuing in 2007, the Company's activities to address and remediate the material weakness in this area reported in 2005 have included:

(a) Hiring or appointing personnel to fill open senior financial positions necessary for an effective financial reporting organizational structure including qualified and experienced personnel for corporate, business unit, international and regional accounting; cost accounting; financial planning and analysis; revenue accounting; and tax compliance. Personnel were hired primarily into open positions at its U.S. headquarters, in China, and in the Asia–Pacific and Europe, Middle East and Africa ("EMEA") regions. In addition, the Company hired or appointed personnel to fill open senior financial compliance and internal audit positions at its U.S. headquarters and in China and India.

(b) Implementing, in the first quarter of 2007, a new "management by objectives" system which will be used globally to capture corporate and executive management goals and articulate them throughout the organization, and to cascade and align

each employee's goals to support corporate objectives. The goal setting, monitoring and evaluation process will incorporate capturing employee's training and development requirements, including training to stay current with the application of GAAP and the company's code of business conduct and ethics.
(c) Retaining the services of outside consultants with relevant accounting experience, skills and knowledge in the application of GAAP, working under the supervision and direction of the Company's management, to supplement the Company's existing finance personnel.
(d) Continuing to allocate the necessary resources to hire additional finance, internal audit and compliance personnel in the U.S., China, India, and elsewhere, as necessary, with knowledge, experience and training in the application of GAAP commensurate with the Company's financial reporting requirements.
2. Revenue Recognition—The Company's planned remediation measures are intended to address material weaknesses related to revenue and deferred revenue accounts and associated cost of sales that have the potential of misstating revenue, deferred revenue and associated cost of sales in future financial periods. These measures, at its U.S. headquarters and international (excluding China) locations, include the following:
(a) Hiring and training additional experienced revenue managers and supporting staff to support the preparation and analysis of revenue recognition and deferred revenue accounts.
(b) Enhancing the contract review process to include requiring sales, operations, finance and legal staff to provide input during the contract negotiation process to ensure timely identification and accurate accounting treatment for non–standard contracts.
(c) Enhancing the policies, procedures and guidelines around recognizing and deferring revenue, and better defining the timing and extent of a second level of management review at its U.S. headquarters of revenue recognition for certain transactions.
(d) Implementing additional procedures to enhance controls around recognized and deferred revenue to ensure the completeness, accuracy and validity of recognized and deferred revenue, including reviewing sales hold reports and fulfilled progress billing sales orders reports to ensure that revenue is completely recorded and a secondary review of maintenance transactions to ensure the amounts are amortized accurately.
(e) Implementing enhancements to its Oracle financial system which improved its automated processes and controls related to revenue and deferred revenue accounting.
(f) Increasing the level and coverage of training conducted by revenue accounting personnel related to revenue recognition, including the impact of amendments and side agreements. During the first quarter of 2006, several training seminars were conducted for various sales and services teams in North and South America. In the second quarter, additional revenue recognition training was provided to personnel in North America and training was also conducted for the EMEA sales group. In the third quarter, training was conducted in the Philippines and in the US for Caribbean and Latin American ("CALA") based sales and services personnel. In October 2006, the Company's key management participated in a seminar on the critical factors associated with revenue recognition. In addition, certain revenue accounting personnel attended various revenue recognition seminars through–out the year as part of their on–going training.
(g) Expanding, in the third and fourth quarters of 2006, the number of disclosures included in the certifications to senior management with respect to identification and communication of contract amendments, side agreements or other matters which could have a bearing on revenue recognition, as well as the number of personnel required to perform such certifications. The Company also implemented additional steps to ensure appropriate members of management have reviewed and confirmed critical information necessary to ensure proper revenue recognition accounting.
3. Inventory Management—The Company's planned remediation measures are intended to address material weaknesses related to inventory, deferred costs, inventory reserve accounts and cost of sales that have the potential of misstating inventory and deferred costs and expected recoverability of inventory in future financial periods. These measures include the following:
(a) In March 2006, the Company hired an international cost accounting director and, in October 2006, the Company in China hired a director of finance, supply chain, both with relevant GAAP experience, skills and knowledge. In November 2006, the Company hired an assistant controller and a shared services manager at its U.S. headquarters whose responsibilities include overseeing the international cost accounting function. These personnel have considerable experience and training in cost accounting and utilization of the relevant Oracle financial system modules. The Company believes the addition of these personnel improves and strengthens the capabilities for the manual analyses and management review required of this function.

(b) During the second quarter of 2006, the Company implemented enhancements to its Oracle system which will improve its ability to more effectively track inventory and evaluate deferred costs.
(c) In the first quarter of 2007, the Company enhanced its processes and procedures related to properly tracking and confirming inventory movements to ensure the proper classification of inventory, including finished goods at customer sites, and deferred costs (and associated accounts such as Purchase Price Variances), and to ensure the completeness and accuracy of the recording of the cost of sales when revenue is recognized. The revised processes include involving and obtaining detailed and timely input from business unit, operations and sales operations personnel to enhance the information available for finance to analyze these accounts. New reports have been developed and reports and procedures will continue to be enhanced as necessary to facilitate the accuracy of accounting for these processes. In addition, finance management has placed increased attention on reviewing in detail the accounting in this area.
(d) Throughout 2006 and continuing in 2007, the Company enhanced and will continue to augment its processes and procedures related to the evaluation of its inventory reserve accounts, including the development of detailed inventory reserve reports and additional review of reserve accounts by management.
4. Recording of Accrued Expenses—The Company's planned remediation measures are intended to address a material weakness related to the Company's recording of accrued expenses that has the potential of misstating accrued expenses and related income statement accounts in future financial periods. The Company's remediation measures include the implementation in 2006 of control processes at its U.S. headquarters and in China, which included:
(a) Enhancing the process to review open purchase orders, invoices and disbursements after the end of each quarter to ensure proper recording of accrued expenses and open purchase order commitments.
(b) Hiring additional resources into the Company's accounting and accounts payable functions at its U.S. headquarters and in China. In addition, in November 2006, the Company hired an assistant controller and a shared services manager at its U.S. headquarters whose responsibilities include overseeing the accounts payable and corporate accounting functions. These personnel add considerable experience and training in accounting and oversight for accounts payable and accrued expenses for the consolidated financial statements and utilization of the relevant Oracle financial system modules. The Company believes the addition of these personnel improves and strengthens the capabilities of this function.
(c) Enhancing, in the first and second quarters of 2006, the Company's processes and procedures related to properly tracking and reviewing open purchase orders and reviewing of subsequent receipts, invoices and disbursements after the end of each month to ensure proper recording of open purchase order commitments, accrued expenses and related income statement accounts. The Company plans to continue enhancing reports and procedures, as necessary, to facilitate the accuracy of accounting for these processes. In addition, finance management both in China and at its U.S. headquarters have committed to place increased attention on reviewing the accounting in this area.
5. Accurate Preparation and Review of Financial Statements and Segment Reporting—The Company's planned remediation measures are intended to address material weaknesses related to the financial close and reporting process that have the potential for preventing the accurate preparation and review of the Company's consolidated financial statements in future financial periods. These measures include the following:
(a) During the first nine months of 2006, the Company implemented and plans to continue to improve procedures to ensure that non–routine transactions are identified and escalated to senior financial management during the close process to help ensure proper accounting treatment;
(b) During the first nine months of 2006, the Company implemented and plans to continue to augment month and quarter–end closing procedures to standardize its processes for financial review to ensure that U.S. reviewers monitor financial information from decentralized locations in a consistent manner;
(c) During the first nine months of 2006, the Company's corporate finance department expanded and plans to continue to enhance the required reporting package from various business units and subsidiaries in order to ensure it has accumulated the necessary accounting, finance and operational information to effectively analyze information required for financial statement preparation and footnote disclosures; and

(d) In addition, in 2006 the Company's external reporting department expanded and plans to continue to improve the documentation and review of required information associated with the preparation of its quarterly and annual filings under the Exchange Act.
(e) In the fourth quarter of 2006, the Company's finance department commenced an initiative to "refresh" its finance and accounting policies and procedures. Through this initiative, which the Company expects will be ongoing throughout 2007 and beyond, the Company's financial policies and procedures will be reviewed for completeness, accuracy and adequacy, updated and brought current, and standardized globally as necessary and appropriate. A communication plan will also be developed to ensure "refreshed" policies and procedures are publicized and understood, and appropriate employees are trained in their application, as necessary. The Company expects this initiative will form the foundation for the process to maintain and keep current its finance and accounting policies and procedures on a go-forward basis. In addition, starting in the fourth quarter of 2006, the Company commenced internal audits of, and in 2007 plans to continue to expand and increase the scope of its efforts to monitor, controls at the Company's decentralized and remote operations globally, through reviews and audits of employee compliance with applicable policies and procedures at business units, subsidiaries and other locations.
6. Income Tax Analysis—The Company's planned remediation measures are intended to address material weaknesses related to the calculation of its provision for income taxes that have the potential of misstating the provision for income taxes and related balance sheet accounts in future financial periods. These measures include the following:
(a) The Company hired and trained additional experienced tax managers and supporting staff during the first nine months of 2006 to support the preparation of the Company's income tax provision and to assist in managing audits and to monitor tax compliance in China and other foreign locations;
(b) During the first nine months of 2006, the Company utilized outside consultants, other than the Company's independent registered public accounting firm, to assist the Company's management in the analysis and calculation of its income tax provision and related balance sheet accounts. The Company plans to continue to utilize such outside consultants to assist in its analysis and calculation of such matters in future periods, as necessary; and
(c) Throughout the first nine months of 2006, the Company developed and continues to augment a more formalized and comprehensive process to accumulate and organize financial and tax data used in connection with income tax calculation and reporting.
7. Segregating duties and user access—The Company's remediation measures are intended to address a material weakness related to the segregation of duties and user access to certain J. D. Edwards business process applications associated with the Company's Personal Communications Division that have the potential of misstating various accounts in future financial periods. These measures include the following:
(a) During the first quarter of 2006, the Company removed access rights from certain employees associated with inappropriate segregation of duties;
(b) On a quarterly basis, management review and modify, as necessary, access privileges to the J. D. Edwards business process applications; and
(c) The Company expanded its level of management oversight related to areas associated with segregation of duties and user access issues including changes to the general ledger master file, invoice terms and inventory.

Interim Measures. Management has not yet implemented and/or tested the effectiveness of all the measures described in items 1 through 7 above. Nevertheless, management believes those measures identified above as having been implemented, together with the other measures undertaken by the Company described below, all of which were undertaken during the three quarters of 2006 or subsequent to September 30, 2006 in connection with the September 30, 2006 quarter-end reporting process, address material weakness 1 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10-K. These other measures include the following:
1. The Company retained on an interim basis outside consultants, other than the Company's independent registered public accounting firm, with relevant GAAP experience, skills and knowledge, working under the supervision and direction of Company management, to assist with the September 30, 2006 quarter-end reporting process.
2. The Company conducted an additional review of a substantial majority of its revenue-generating contracts for compliance with revenue recognition criteria. As part of this review, the Company gathered and analyzed evidence of delivery and final acceptance.

3. The Company performed the following reviews of inventory–related matters: it reviewed consolidated revenue schedules from the quarter to determine the proper recording of cost of goods sold; it conducted a reconciliation of inventories at customer sites to outstanding contracts as of the quarter–end and analyzed inventory for recovery and potential impairment; and it conducted an analysis of inventory relating to purchase orders to identify under–recorded inventory.
4. The Company conducted a review of the processes to record inventory reserves and a review of the manual procedures by which the Company tracks the cost of its products.
5. The Company conducted a variety of manual review procedures, such as an extensive review of journal entry postings into the Oracle system and an extensive review of account reconciliations.
6. The Company conducted a detailed and extensive review of the following: non–routine transactions and internal representations; financial statements, as well as certifications from decentralized locations, for accuracy; spreadsheets; and journal entries.
7. The Company reviewed its reserves and related schedules and reported its findings to the Audit Committee.

Material weakness 2 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10–K

Remediation Initiatives. The Company's failure to ensure that key management fully understood the nature and potential significance of related parties and to ensure that a robust process for the identification of related party transactions contributed to the Company's failure to maintain effective controls over the identification of and accounting for related party relationships and related party transactions with the Company. To remediate material weakness 2 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10–K, the Company has implemented or plans to implement the measures described below, and will continue to evaluate and may in the future implement additional measures.

1. In the fourth quarter of 2005, the Company further expanded the number of Company personnel required to certify to senior management quarterly with respect to identification, recognition and disclosure of related party transactions for SEC reporting purposes, and revised the Company's internal certification process concerning identification, recognition and disclosure of related party transactions. The listing of personnel required to so certify to senior management is reviewed and updated each quarter as part of the Company's disclosure procedures.
2. During 2006, the Company conducted periodic training sessions with key managers and senior executives regarding the Code of Conduct, including the identification, recognition and disclosure of related party transactions.
3. The Company continued to evaluate the Company's procedures to ensure the identification, recognition and disclosure of related party transactions.
4. The Company provided key managers and senior executives with access to legal and accounting personnel to enable such managers and executives to more accurately and comprehensively comply with the Company's internal certification process for SEC reporting purposes.
5. During 2006, the legal department conducted training programs for executive management and personnel in various offices, which included training on related parties.

Interim Measures. Management has not yet implemented and / or tested the effectiveness of all of the measures described. Nevertheless, management believes those measures identified above as having been implemented, together with the other measures undertaken by the Company described below, all of which were undertaken during the first three quarters of 2006 or subsequent to September 30, 2006 in connection with the September 30, 2006 quarter–end reporting process are sufficient to address material weakness 2 described in "Management's Report on Internal Control Over Financial Reporting" in Item 9A of the 2005 Form 10–K. These other measures include senior executives providing new certifications regarding related party transactions.